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FEDERAL SECURITIES LAWS AND DEFENSE CONTRACTING—Part 3

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON
ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

SEPTEMBER 23, 1985—PROCUREMENT ABUSES BY THE AIR FORCE, GENERAL DYNAMICS CORP., AND WESTINGHOUSE CORP.
OCTOBER 2, 1985—QUESTIONABLE USE OF FOREIGN CONSULTANTS
OCTOBER 10, 1985—OFFSETS ASSOCIATED WITH FOREIGN MILITARY SALES

Serial No. 99-93

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ORIGINAL

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Printed for the use of the Committee on Energy and Commerce

U.S. GOVERNMENT PRINTING OFFICE
62-185 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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FEDERAL SECURITIES LAWS AND DEFENSE CONTRACTING

Procurement Abuses by the Air Force, General Dynamics Corp., and Westinghouse Electric Corp.

MONDAY, SEPTEMBER 23, 1985

House of Representatives,
Committee on Energy and Commerce,
Subcommittee on Oversight and Investigations
Washington, DC.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2123, Rayburn House Office Building, Hon. John D. Dingell (chairman) presiding.

Mr. Dingell. The subcommittee will come to order.

For more than a year now, the subcommittee has been conducting an investigation to determine, whether our major corporations are operating in a manner, that accords with Federal securities laws and regulations, as enforced by the Securities and Exchange Commission.

In hearings to date, we have focused primarily on the General Dynamics Corp.—one of the Nation's largest defense contractors. This case study began with our receipt of allegations that the company's senior executives, deliberately attempted to manipulate its stock, and to defraud the Navy on nuclear attack submarine contracts.

In addition to its violations of our securities laws, the subcommittee has learned that General Dynamics has engaged in such other activities, as falsifying books and records, failing to disclose cost overruns in the submarine program, failing to adhere to cost accounting standards, and engaging in questionable foreign payments, to name but a few examples of securities law violations.

These activities of defense contractors raise serious questions, about the integrity of corporate management, and of the reports filed with the Securities and Exchange Commission. Since the very basis of our financial market system is reliable information, designed to instill public confidence, these questions are of the utmost importance. What makes these matters even more serious, of course, is that we are talking about companies engaged in building this Nation's defense systems.

Already we have seen and heard enough for us to recognize that our defense procurement system is not working; that defense contractors charge the Government, any price they think they can get, with a "catch-me-if-you-can" approach to charges which may be improper.

Today's hearing is structured in a way, which should illustrate what can and does go wrong with our procurement system, and how it goes wrong. The items we will discuss should illuminate exactly how the Defense Department, can end up with a $640 toilet seat, a $435 ordinary hammer, a $600 ashtray, and a $670 armrest for the C-5A Air Force cargo plane. Some of the items we will discuss today resemble that armrest, in that, the Air Force ultimately found a way to make the product for far less money than the contractor—in the case of the armrest, $27.

The focus of today's hearings follows the subcommittee's request to the General Accounting Office, to investigate one single modification to the Air Force's contract with General Dynamics Corp. for the F-16.

The GAO inquiry focuses on a spare parts acquisition, for which the Air Force allowed more than a million dollars, with absolutely no strings attached. This practice, incidentally, of allowing the taxpayer to be bilked, by placing unpriced orders, is no small matter. In 1983, unpriced orders amounted to $5.9 billion, and by 1984 this had nearly doubled, to $10.9 billion.

The GAO report details how two major defense contractors, offered the Air Force parts, for which the Air Force spent thousands, and thousands of dollars; these parts should have cost very little. In some cases, those spare parts had already been manufactured—at Government expense—and were thus not needed. In some cases, the parts were made and did not work. Both companies, with General Dynamics as the prime contractor on the F-16, and Westinghouse as the subcontractor on radar, knowingly engaged in padding the purchase.

I will leave it to our GAO witnesses, to inform the subcommittee on the overall scheme, except to share with my colleagues one example which, for me, epitomizes the worst of a bad lot. Were it not so pathetic, the purchase of an "alignment pin" would be laughable.

General Dynamics suggests the need for a 3-inch alignment pin, and fixes a price of $14,835 for two. The subcontractor, Westinghouse, asks $7,150. To design this 3-inch pin, Westinghouse claims to expend 63 hours of engineering time. Ultimately, the project is cancelled; General Dynamics fixed a lowly price of $44 for the drawings, and paid Westinghouse $38, leaving General Dynamics $6 for overhead and profit.

The Air Force, in turn, made a pin for $45, using the Westinghouse drawings. Unfortunately, that pin arrived late, so a technician at the scene of the repair made a substitute—a 3-inch piece of hard wire he clipped from the store room. Westinghouse, by the way, does not use metal alignment pins, but uses wooden sticks.

This example, and others, we will hear about this morning should raise alarm bells all across this country. The Nation is expected to spend more than $300 billion on defense in the next year, and we are seeing that money slip away with no appreciable increase in our security.

We will hear first from the General Accounting Office, and I want particularly to commend GAO for its work. The individuals who have done that work, have performed in a most outstanding fashion, and under the most difficult of conditions.

Following the General Accounting Office witnesses, the subcommittee will hear from the panel comprised of the Air Force and of General Dynamics and Westinghouse officers. I am sure the subcommittee will be most interested and eager, and I think the taxpayers will be most interested and eager, to hear explanations by the Air Force, General Dynamics, and Westinghouse of the General Accounting Office's findings.

[The following letter was submitted:]

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U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
Washington, DC 20515

September 19, 1985

The Honorable Caspar W. Weinberger
Secretary of Defense
Department of Defense
The Pentagon
Washington, D. C. 20301

Dear Mr. Secretary:

As we have discussed, the Subcommittee on Oversight and Investigations has been conducting an ongoing investigation of various activities of the General Dynamics Corporation relating to the Federal securities laws. The evidence of gross malfeasance uncovered so far has included the falsification of books and records, apparent stock manipulation, failure to properly disclose overruns, illegal entertainment of military officers and government officials, failure to adhere to cost accounting standards, clear and knowing breaches of submarine procurement contracts, fraudulent billings against the government, violations of national security, questionable foreign payments, conflict of interest, bribery schemes involving top management officials -- to name a few. These activities obviously raise serious questions about the integrity of corporate management and the reports they file with the Securities and Exchange Commission (SEC).

For some time, we have been fascinated with the revelations of the $640 toilet seat, the $435 hammer, and the $600 ashtrays. It is most curious why there has been no apparent follow-up, no explanation of how these things could have happened, and no effort to identify those responsible for these bizarre acquisitions. The role of the management of our major defense contractors in manipulating these questionable acquisitions and the Defense procurement process is of major interest to the Subcommittee and undoubtedly to the SEC.

The Subcommittee directed the General Accounting Office (GAO) to investigate a single modification to the Air Force's F-16 contract with the General Dynamics Corporation to determine: (1) who is responsible for generating the original requirement for the procurement, the not-to-exceed contract price, and the individual prices of the equipment at General Dynamics and Westinghouse; and (2) who approved the requirement, the prices, and the "urgent" unpriced contract in the Air Force. This contract modification involved the acquisition of 24 items of support equipment for the Air Force to repair the radar antenna of the F-16 fighter aircraft. As you know, this support equipment was the source of some controversy in November 1983 when it was the subject of a Senate hearing. This buy includes the infamous 12-cent Allen wrench that General Dynamics and Westinghouse were developing, producing, and selling to the Air Force for $9,609. The GAO was directed to determine the name of the engineer who actually charged 63 hours of engineering time contemplating a three-inch piece of common wire that was to be sold to the Air Force for $9,376.

The Subcommittee could easily have identified a new procurement horror story and conducted the same kind of in-depth review, but, we wanted to take a procurement that the two corporations and the Air Force were already fully aware of and determine how it happened and who, if anyone, was held accountable at General Dynamics, at Westinghouse and in the Air Force.

The findings of the GAO review are devastating. Not only did General Dynamics and Westinghouse plot to develop and produce tools at an outrageous price -- tools that the Air Force had already paid Westinghouse to develop and had been in use at Westinghouse for over 5 years -- but, the two companies sold the Air Force tools that were not even needed by the Air Force. In addition, the GAO found two incidents of defective pricing, examples of misbilling and highly questionable time charges.

What has happened to good old American ingenuity and common sense? If I were in charge of the F-16 program and decided to fix the radar in-house, I would have put my best technician on a plane to Westinghouse, told him to watch Westinghouse technicians fix the radar for two days and return with a set of tools. Any self-respecting taxpayer would have done the same. But not the Air Force. The Air Force let a $1.7 million contract three years ago and is yet to fix a single radar.

General Dynamics, as the prime contractor, has a contractual and ethical responsibility to make proposals to the Air Force for necessary equipment for the maintenance of the F-16 aircraft in the most cost effective manner. General Dynamics is paid to protect the Air Force's interest. General Dynamics knew full well that the Air Force had already paid Westinghouse for the development of these tools. This is not sloppy business practice on the part of General Dynamics -- it is fraud. The entire acquisition was clearly double billed. It is fraud on the part of Westinghouse to plot with General Dynamics. This raises serious questions about the integrity of corporate management of both General Dynamics and Westinghouse. It is also not the finest hour for the Air Force for having allowed this to happen. As the GAO points out, the safeguards in the acquisition system which could have stopped this fraud were simply ignored.

The solution to these bizarre acquisitions is not the announcement of another new 10-point program; the solution is accountability. Action should be taken against contractors who engage in this sort of deception against the government. Action should also be taken against the Air Force personnel who failed to protect the government and the taxpayers. This is only a $1 million modification out of 580 modifications to the F-16 contract. There is no reason to believe, however, that this is a unique situation and not any different from the other 579 modifications in the $55 billion total F-16 program or in the $140 billion worth of weapons acquisitions made by the DOD annually. This kind of behavior by the contractor and the military services could be costing the taxpayers tens of billions of dollars annually.

Let me summarize some of the other findings of the GAO investigation:

-- extensive use of unpriced contract orders putting the government in a virtually "no win" negotiating position. Unpriced orders are a "license to steal";

-- the Air Force's almost standard use of the "urgency" clause as a convenient excuse to use unpriced contract orders with a total disregard for price. For example, one "urgently" needed item in this modification is missing from the inventory but went unnoticed until the GAO tried to find it. We understand that a 10-man DOD team is now looking for the item;

-- contractors' total lack of integrity in dealing with the government and promoting a "buyer beware" attitude with the government by not thoroughly evaluating the option of using existing tools as required in the contract;

-- the Air Force's routine review and acceptance of contractor recommendations for "new" development of support maintenance equipment even though the system had been maintained already for 5 years by Westinghouse;

-- double billing for support equipment already in existence. For example, 14 Westinghouse tools were designed, developed and manufactured under its government contract and then redesigned, redeveloped and remanufactured under different part numbers for the Air Force;

-- fraudulent intent by changing part numbers on previously used support equipment in an apparent attempt to deceive the government;

-- numerous "errors" in direct labor and material charges, such as labor and materials charged to an item more than a year after the item had been manufactured and delivered to the Air Force;

-- defective pricing on two of the items supplied by General Dynamics. This finding is very serious. General Dynamics had already built a large number of these boresight fixtures; obviously they knew what they cost. Such "errors" are hard to accept as mistakes. It is interesting to note that all of the "errors" discovered by the GAO are in favor of the contractor;

-- General Dynamics' recommendation of support equipment items that were not even used by Westinghouse for maintenance of the radar. For example, the Air Force paid $164,000 for a vacuum/head maintenance stand that is not used by Westinghouse. The Air Force has still not used the stand because they have yet to receive a technical order showing how to use it. Also, General Dynamics proposed the purchase of an antenna motor brush assembly tool at a price of $10,624. However, Westinghouse does not use such a tool, but instead uses a three-by-eight inch sheet of flexible plastic, and additionally, Westinghouse uses a wooden stick as an assembly alignment tool -- but recommended a $14,835 steel alignment pin for use by the Air Force; and

-- the Air Force paid for extensive testing to assure that the new Westinghouse tools worked properly. The Air Force did not get what it paid for even though all parties said it did. For example, the pulley puller the Air Force paid $8,832 for does not work.

It is important for you to understand that the GAO debunked a phony idea widely spread by some Air Force generals that the $435 hammer is the result of the "equal allocation of overhead" to these parts which are of minimal intrinsic value. The 12-cent Allen wrench did not increase to $9,606 by the "equal allocation of overhead" -- General Dynamics and Westinghouse actually charged engineering time to the wrench that resulted in that kind of price. According to an examination of the labor records, Westinghouse charged 63 hours of engineering time to develop a three-inch piece of common wire for $14,835 -- a tool officially dubbed an assembly alignment pin -- when Westinghouse had been using a wooden peg for five years for the same purpose.

The DCAA report on this modification was clearly unacceptable by any standard. How can they recommend a proposal as adequate for negotiation when over one-half the price was based on "telephone quotes"? In the face of some items being overpriced by as much as a factor of 10,000 -- DCAA recommended a reduction in the contract price of 11%.

On Monday, September 23, 1985, the Subcommittee will hold a hearing on the findings of the GAO investigation. We will receive testimony from the GAO along with witnesses from the Air Force, General Dynamics and Westinghouse. Air Force Secretary Verne Orr will testify before the Subcommittee in mid-October on this issue and several others. I will forward a copy of the transcript of this hearing for your review immediately following the hearing. This issue will be one that the Subcommittee will be discussing with you in the near future.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

JDD:PScm

cc: The Honorable Verne Orr
Secretary of the Air Force

Mr. **Dingell**. The Chair will now recognize my colleagues for opening statements. The Chair notes that the Chair will hear first the gentleman from Oregon, Mr. Wyden.

Mr. **Wyden**. Thank you, Mr. Chairman.

In the past, I have talked about how the taxpayers are fleeced by the Pentagon's current system of purchasing weapons. This morning, we will examine a case study that should be a must for any handbook on how to fleece the taxpayer.

The evidence shows that General Dynamics intentionally—and in clear breech of its contractual responsibility to the Government—ripped off taxpayers by recommending the purchase of simple tools at outrageously high prices.

The process used by General Dynamics—contracting through unpriced orders—is nothing more than an invitation to pilfer. With unpriced orders, the Government is obligated to pay costs incurred by the contractors. In effect, the Government has to pay the contractor's price without ever having a say in what the price is.

Even though unpriced orders are sometimes warranted, the Government has created a massive exemption to sound contracting principles by using them excessively. The fact is that unpriced orders—at the Air Force alone—have increased from $5.9 billion in September 1983 to $10.9 billion in September 1984.

McDonnell Douglas is reported to have more than $1 billion in unpriced orders outstanding today, and Westinghouse Corp. more than $100 million. Given that the Pentagon has fallen billions of dollars behind in obligating available funds, the excessive use of unpriced orders seems to be a convenient—even if inefficient—way to get the money out the door quickly. Not being able to spend the money fast enough, it seems that it is being thrown into the streets.

Contracting through unpriced orders produced the $8,832 pulley puller. This is a 2-inch piece of metal intended to remove pulleys from the F-16 radar system.

I would just show my colleagues that this is what the $8,832 pulley puller looked like. Yet, I think it is worth noting that a small Dallas machine shop was recently asked to engineer and manufacture this very same item. They produced this. They delivered it to Washington, DC, in less than 48 hours for a price of $69. And they said that if it was purchased in quantity by competitive bidding in all probability the unit price would be $35.

What seems incredible is that the Air Force seems to defend the practice that was used to produce the $8,832 pulley puller today. The fact is, Mr. Chairman, the contractors are telling us what to buy, how to buy it, and what to pay for it; and it is this system that is pushing us toward the brink of fiscal disaster.

My last point is, I am convinced that if Willie Sutton, the legendary bank robber, was alive today, he would be powerfully attracted to the military contracting field. Not only is this—to paraphrase Willie—"where the money is," we now know that there are spectacular opportunities for illicit gains.

My congratulations to you, Mr. Chairman, for your tenacity in exposing these taxpayer swindles and your perseverance in pursuing new procedures that would give our citizens their buck's worth in military contracting.

Mr. **Dingell.** Thank you, Mr. Wyden.

The Chair recognizes the gentleman from Michigan, Mr. Sikorski.

Mr. **Sikorski.** Thank you, Mr. Chairman.

I want to commend you for continuing this significant series of hearings. I particularly look forward to the testimony we will hear today because I believe it explains for the first time how the defense procurement scam works, how it got that way, why it stays that way, and why it is getting worse year after year after year.

Last winter, we all sat in this same room and heard the incredible story that General Dynamics and Pratt & Whitney billed us for dog boarding and vacations to Pago Pago; that generations of Government contracting officers have consistently approved outrageous charges to the taxpayers without blinking an eye; and that many of them then swung through the revolving door into well-paying jobs with defense contractors, leaving us to question whether those nice jobs were payment for a "job well done" while they supposedly had been serving the citizens of America.

Our investigation over the last 1½ years has graphically illustrated a system rife with greed, malfeasance and contempt for our Nation's laws and our Nation's taxpayers. However, this latest in-depth investigation conducted by the General Accounting Office at the chairman's direction shows us specifically and at each step in the process who should have been minding the store, how two giant defense contractors defrauded the taxpayers, and how negligent Air Force personnel helped them do it.

We are all tired of hearing about $640 toilet seats and the $9,000 Allen wrenches that should have cost us 12 cents. But this report goes far beyond that: It shows how General Dynamics and Westinghouse were partners in a con game to gouge the taxpayers by recommending the design and development of tools that taxpayers had already paid for the design and development of, that had been in use for 5 years, and that had already been used to repair some 2,200 F-16 radar antennas.

It shows also how these contractors sold the Government tools that were wholly unnecessary or unworkable for the job at hand—one costing us $8,832 can't be worked; one costing us $164,000 has been sitting in a crate for a year awaiting instructions; and one costing us $3,626 is lost.

It also shows how the contractors charged the taxpayers up to 10,000 times more than these tools should have cost. Engineers allegedly spent 63 hours contemplating how to make an alignment pin, only to find that an Ogden Air Force technician could make it from a simple coat hanger and small block of wood in a few minutes.

GAO's findings on the Air Force and DOD culpability in this scheme is no more encouraging. The Air Force needlessly let an unpriced contract to General Dynamics for tools that it presumably "urgently needed." GAO found that there was no urgent need and no justification for rubberstamping this bonanza for General Dynamics and Westinghouse.

When questions were raised by an alert Air Force Plant Representative Office, AFPRO, about the cost of these simple tools, his supervisors ignored the warnings. And even further up the chain, the Defense Contracting Auditing Agency failed to put a stop to it, recommending only 11 percent less than General Dynamics had asked for—despite outrageous overbilling by huge factors.

This report details a system that is rotting from the inside. There is too much greed, too little accountability, and too little control on the spigot of taxpayers' dollars to defense contractors.

Americans are sick and tired of these defense contractors robbing the taxpayers' bank and DOD driving the getaway car.

Attorney General Meese must make good on his word of just last week to crack down on this kind of white-collar crime. He must put his lawyers where his mouth is and pursue these corporate criminals and their allies in Government who would relinquish their public responsibility for private gain.

Thank you, Mr. Chairman, for your dedication to the public interest.

Mr. DINGELL. The Chair thanks the gentleman.

The Chair recognizes now the distinguished gentleman from Texas, Mr. Bryant.

Mr. BRYANT. Thank you, Mr. Chairman.

I would also like to thank you and congratulate you for continuing to pursue this matter as it has been pursued for this entire year during a time when apparently some others have not been anxious to pursue it.

The report given to us prior to this hearing today details the most disgusting instances of buckpassing, of backside covering, hiding, covering up, incompetence and waste, and as far as I am concerned plain stealing on the part of many of the participants in this hearing, as well as one we have had already, stealing from the taxpayer. And I think that it is time that the taxpayers had an accounting of exactly who is responsible for it and exactly who has been responsible for misleading the public into believing that somehow or another these outrageous charges for individual tools were a result of an accounting system, when obviously they are not.

I think it is very important that we recognize today that we are going to have some men in uniform testifying before us; that regardless of whatever feats of bravery or valor in action they may have participated in in the past, today they are simply bureaucrats, Government managers, just like people who hand out welfare checks. And the way it appears to me is they have been handing out a few welfare checks themselves from the Pentagon.

I think, Mr. Chairman, that in addition to revealing this today, if all is as it seems to be according to the preliminary information that we have been given, we ought to see to it that there is loss of rank for those in the military, for those who have failed to manage the public's business correctly; that there are losses of contracts for those defense contractors who have gouged and wasted and misadvised us; that there is loss of dollars—we ought to get this money back for the taxpayer; and that there is a loss of personal freedom—and by that I mean available for those who through the system may have stolen from the taxpayer just like a person who steals from a 7-11 or a person who robs a bank or snatches a purse.

Thank you for persisting in this investigation, and I look forward to hearing from the witnesses.

Mr. DINGELL. The Chair thanks the gentleman.

The first panel before the subcommittee today will be a panel of witnesses from the General Accounting Office: Mr. Frank C. Conahan, Director, National Security and International Affairs Division; and Mr. Joe D. Quicksall, Senior Evaluator, U.S. General Accounting Office, Dallas, TX.

Gentlemen, if you would please come forward to the table and take your seats.

The Chair advises that it is the practice of the subcommittee in all of its proceedings that all witnesses are sworn. Do either of you gentlemen object to testifying under oath?

Mr. **Conahan**. No, sir.

Mr. **Quicksall**. No, sir.

Mr. **Dingell**. Do either of you desire to have counsel at the witness table with you to advise you on your rights?

Mr. **Conahan**. No, sir.

Mr. **Quicksall**. No, sir.

[Witnesses sworn.]

Mr. **Dingell**. You may each consider yourself to be under oath.

For the assistance of each of you gentlemen, there are, there at the witness table in the blue and the blue-green booklets, the rules of the House, the rules of the committee, and the rules of the subcommittee so that you may appreciate fully not only your rights before the committee but the limitations on the power of the committee as you testify before us today.

Before we commence, I have a couple of modest observations with regard to the performance of the General Accounting Office and each of you and your associates who have worked on this matter.

Quite honestly, your performance is extraordinary and I believe that you merit the gratitude and the appreciation not only of the subcommittee but of the Congress and the American people. And I hope that you will carry with you not only the real expression of the appreciation of the subcommittee, and the chairman thereof, but also the appreciation of the American people for you have performed in the finest traditions of not only your Agency but Government service. And I believe that you have made an extraordinary contribution to the proceedings of this subcommittee.

You have, I hope, made an extraordinary contribution to the defense of our Nation in reducing some of the excessive charges and making it perhaps possible for us to afford the defense of our Nation. We will ascertain your success in the last particular by how the Defense Department uses your testimony and how they correct the abuses that are so clearly obvious in the excellent analysis which you have made of matters before the subcommittee today.

Gentlemen, you are welcomed for statements in such order as you wish. If you would, please, however, for purposes of the record, identify yourself each before you commence, commencing with Mr. Conahan.

TESTIMONY OF FRANK C. CONAHAN, DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE, AND JOE D. QUICKSALL, SENIOR EVALUATOR, GAO, DALLAS, TX, ACCOMPANIED BY NANCY KINGSBURY, AGENT

Mr. CONAHAN. Thank you, Mr. Chairman. We appreciate being here today.

I do have a detailed statement that I would like to submit for the record and then summarize that statement on behalf of the General Accounting Office.

Mr. DINGELL. Without objection, the entirety of your statement will appear in the record, and the subcommittee will proceed to recognize you for such summaries as you deem appropriate.

Mr. CONAHAN. Thank you.

Then, both Mr. Quicksall, who was directly in charge of this assignment, and I, will both be available for any answers to your questions.

Mr. DINGELL. That is quite an appropriate way to proceed, and you are recognized, gentlemen, in that order and in that fashion.

Mr. CONAHAN. General Dynamics, under its F-16 contract, is specifically obligated to recommend support equipment to maintain the aircraft. In this instance, it recommended that the Air Force procure 24 items, ranging from tools for use in repair of the fire control radar antenna to test assemblies, fixtures, and adaptors, mostly for other types of maintenance.

Recommendations for most of the items were submitted in January 1982. The Air Force planned to begin its own repair of the radar antenna in late 1984. Repair work associated with the antenna was being performed by Westinghouse, the manufacturer of the radar. General Dynamics recommended these items for procurement as contractor-furnished equipment, which is often the least desirable and usually the most expensive method for obtaining the equipment when compared with obtaining the items by other means, such as directly from the manufacturer or through local manufacture. And I think we will demonstrate that that is the case this morning.

The recommendations were reviewed and approved by the F-16 Systems Program Office at Wright-Patterson Air Force Base, OH, and for the radar antenna related items by the Air Logistics Center in Utah, where the repair work was scheduled to take place.

The officials approved the recommended items without ensuring that General Dynamics had recommended the most cost-effective source as required by the regulations. The General Dynamics recommendations clearly showed that equivalent tools were already in use at Westinghouse. Westinghouse had used most of these tools to repair radar antennas for several years prior to General Dynamics' recommendations to develop new tools.

Three items recommended by General Dynamics, and approved as needed by the Air Force, were later canceled because they were not needed. The program office approved an unpriced modification to the F-16 contract in September 1982 to buy the items. That modification authorized General Dynamics and its subcontractors, including Westinghouse, to incur costs for the design, fabrication and/or production of the items up to a not-to-exceed price of $1,685,558.

The approval of this unpriced modification was the critical action in the chain of events in the acquisition, because it committed the Government to payment for incurred costs before the matter was reviewed by officials whose primary responsibility was to evaluate prices.

Air Force Systems Command regulations specifically prohibit use of unpriced modifications except in urgent situations. While the decision to issue the unpriced modification in this case implied urgency of the requirement, the extent of that urgency is questionable since 15 of the items were ordered in September 1982 to support the Air Force repair of the antennas, which was not scheduled to begin until late in 1984. As of July 1985, Ogden had not yet started repairing antennas.

Contracting officers are required by these regulations to negotiate a firm price within 180 days of approval of an unpriced modification. In this case, the prices were not negotiated for 13 to 20 months after the date of the unpriced modification. The 15 Westinghouse items took the longest to negotiate, and all but 1 of the items had been manufactured and delivered by the time final prices were negotiated. Thus, the final prices agreed to were substantially determined by the costs claimed by the prime contractor and subcontractors, plus overhead and profit.

During the procurement process, the Air Force Plant Representative Office and others raised questions about the reasonableness of the prices of the Westinghouse items. In response to a congressional inquiry in late 1983, the Air Force stated that the prices for the Westinghouse items would be vigorously reviewed and negotiated.

Subsequently, the F-16 program office designated four items for local manufacture and bought engineering drawings only for $176. The four items were locally manufactured and the program office was billed $995 for the items.

In contrast, General Dynamics had proposed a total price of $41,514 for the four items, for a difference of $40,519. We found no evidence that local manufacture was considered for the remaining eight noncomplex items.

There are a number of anomalies in this procurement which raise significant questions about the fairness of the Air Force's or the General Dynamics' consideration and evaluation of need, value, source and utilization. I was going to cite some of those examples, Mr. Chairman, but I think that you and your colleagues hit on most of those items in your opening statements, and I think therefore I can leave them for any further discussion that you would like, and make a brief conclusionary statement.

Mr. **Dingell.** They are, however, in the full statement which has been inserted in the record.

Mr. **Conahan.** Yes, sir, they are in the full statement. In fact, the report that we rendered to you a few days ago also contained a complete summary of our observations with respect to each and every one of those items.

And in summary, Mr. Chairman, we believe that the Air Force's use of an unpriced contract modification without timely price negotiations to obtain these items of support equipment for the F-16 resulted in excessive prices for many of the items.

The excessive prices occurred primarily because: one, the issuance of an unpriced contract modification put the Government in an unfavorable negotiating position when prices were finalized; two, General Dynamics did not follow required procedures and recommended items for new development that were already in existence; and three, the Air Force did not follow its regulations and reviewed and approved the recommendations in a mechanical manner instead of ensuring thoughtful consideration of need, value and price.

That concludes my statement, Mr. Chairman. We will be happy to take your questions.

[Testimony resumes on p. 34.]

[The prepared statement of Mr. Conahan follows:]

STATEMENT OF
FRANK C. CONAHAN
DIRECTOR
NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION
U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before you this morning to discuss the results of our review of the Air Force procurement of certain F-16 support equipment from General Dynamics which you requested on January 18, 1985.[1]

In brief, Mr. Chairman, we believe that the Air Force's use of an unpriced contract modification without timely price negotiation to obtain certain items of support equipment for the F-16 aircraft resulted in excessive prices for many of the items. The excessive prices occurred primarily because (1) the issuance of an unpriced contract modification put the government in an unfavorable negotiating position when prices were finalized, (2) General Dynamics did not follow required procedures and recommended items for new development that were already in existence, and (3) the Air Force did not follow its regulations and reviewed and approved the recommendations in a mechanical manner instead of ensuring thoughtful consideration of need, value, and price. Also, we found errors in General Dynamics' cost recording procedures and we found anomalies on some of the individual equipment items.

Our review was limited to one contract modification for support equipment items for one weapon system and, therefore, cannot be the basis for recommendations for reform of a system involving hundreds of thousands of items for hundreds of weapons systems. However, it does raise questions about aspects of the acquisition system. We have initiated a review of the Department of Defense's use of unpriced contract agreements to address these and other questions.

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[1] Observations on the Air Force Acquisition of Certain F-16 Support Equipment from General Dynamics (GAO/NSIAD-85-155, September 18, 1985).

HISTORY OF THE ACQUISITION

General Dynamics, under its F-16 contract, is specifically obligated to recommend support equipment to maintain the aircraft. General Dynamics recommended that the Air Force procure 24 items ranging from tools such as alignment pins and a simple modified hexagon wrench to boresight fixtures and a vacuum/heat maintenance stand. Recommendations for most of the items were submitted in January 1982. Fifteen of these items were for use in repair of the AN/APG-66 Fire Control Radar Antenna. The other nine items were test assemblies, fixtures, and adapters mostly for other types of maintenance. Repair work associated with the antenna was being performed by Westinghouse Electric Corporation, Baltimore, Maryland, the manufacturer of the radar. The Air Force planned to begin its own repair of the radar antenna in late 1984. According to F-16 System Program Office (SPO) officials, this action was to reduce reliance on contractors during times of emergency.

The recommendations were reviewed and approved by the F-16 SPO, Wright-Patterson Air Force Base, Ohio, and for the radar antenna related items by the Ogden Air Logistics Center, Utah, where the repair work was scheduled to take place. On the basis that this equipment was urgently needed, the SPO approved an unpriced modification to the F-16 contract in September 1982 to buy the items. That modification authorized General Dynamics and its subcontractors, including Westinghouse, to incur costs for the design, fabrication, and/or procurement of the items, up to a not-to-exceed price of $1,685,558. The approval of this unpriced contract modification was the critical action in the chain of events in the acquisition because it committed the government to payment for incurred costs before the matter was reviewed by officials whose primary responsibility was to evaluate prices.

Although regulations require prices to be definitized within 180 days, price negotiations with General Dynamics for these items took about 13 to 20 months to complete. By the time the prices were negotiated, most of the Westinghouse items had been manufactured and delivered. The final prices agreed to were substantially determined by the level of costs claimed by General Dynamics and its subcontractors, plus overhead and profit. Final definitized prices for 16 items and drawings for 4 items that were purchased from General Dynamics totaled $835,835. Two of each of the four items were ultimately made by the Air Force for $995.

Of the 24 items included in the contract modification, nine were manufactured by General Dynamics and subcontractors other than Westinghouse. For the nine items, hardware and data packages were purchased for eight of the items and one item was cancelled before the original price proposal was submitted to the Air Force. Fifteen of the 24 items were manufactured by Westinghouse--8 of the items resulted in the purchase of hardware and data packages, drawings only were purchased for 4 items, and 3 items were cancelled after the original price proposal was submitted.

REQUIREMENTS DETERMINATION PROCESS INADEQUATE

Our review of the requirements determination process disclosed that the process did not assure that only needed items were authorized and that the authorized items were obtained in the most cost-effective manner. At several steps in the requirements process, neither General Dynamics nor the Air Force followed proper procedures nor did they comply with regulations intended to assure cost-effective acquisition of support equipment. These deviations set in motion the recommendation, approval, and purchase of equipment items at excessive prices. Also, some items were not needed.

General Dynamics recommended these items for procurement as contractor-furnished equipment, which is often the least desirable and usually the most expensive method for obtaining equipment when compared to obtaining the items by other means, such as directly from the manufacturer or through local manufacture. Under its contract, General Dynamics was responsible for recommending the most appropriate source for obtaining needed equipment. While General Dynamics officials believe they complied with contract requirements, they were unable to document that the assessments required were conducted prior to recommending that the items be acquired as contractor-furnished equipment.

Air Force officials approved the recommended items without ensuring that General Dynamics had recommended the most cost-effective source, as required by regulations. Although the

General Dynamics recommendations clearly showed that equivalent tools were already in use at Westinghouse, the recommendations do not explain why the tools recommended to the Air Force were being assigned different numbers from those already in use at Westinghouse or why General Dynamics was recommending development of existing tools. The existing tools had been developed and several sets of the tools had been manufactured by Westinghouse under its radar manufacturing contract with General Dynamics. Westinghouse had used most of these tools to repair radar antennas for several years prior to the General Dynamics recommendations to develop new tools.

We were told by Westinghouse that General Dynamics did not ask them to supply the tools they used. Westinghouse, we were told, did not offer to do so because the tools were not made to Air Force specifications. Instead, General Dynamics recommended and negotiated with the Air Force prices for development (design engineering hours, manufacture, compatibility tests, etc.) for items that already existed at Westinghouse and were already being used for the purposes recommended by General Dynamics.

In approving the recommendations submitted by General Dynamics, the SPO relied on the Ogden Air Logistics Center to review the recommendations which included the questions of whether (1) the items were needed for the purposes recommended and (2) the recommended source for the items was appropriate. At the time Ogden personnel reviewed the General Dynamics recommendations, we believe the officials involved had insufficient knowledge to make informed decisions about whether the items

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were needed to repair the antenna. They had not received any of the technical manuals describing repair procedures, did not have contractor cost estimates for the items, nor assurance that General Dynamics had made the assessments required before recommending the development of items to be furnished by General Dynamics.

We were told by one of the reviewing officials that the Ogden support equipment recommendation review committee relied heavily on the contractor's recommendations that the items were needed. This process resulted in some items being authorized which were not needed. For example, one item which was subsequently cancelled, the antenna clamp alignment tool, was recommended by General Dynamics, approved by the Air Force and later discovered to duplicate the function of one of the other items recommended and approved in the same package--the antenna tape block tool. Two additional items were recommended by General Dynamics and approved as needed by the F-16 SPO and Ogden, but were later cancelled because they were not needed. The Air Force paid $838 in termination costs for the three cancelled items. In addition, we found that three of the approved items were not used at the Westinghouse Electronic Repair Center to repair the radar antennas. These were the vacuum/heat maintenance stand, brush assembly tool, and the alignment pins.

We were told by Ogden officials that their concurrence in the General Dynamics recommendations for support equipment extended only to the need for the item and not to procurement source or cost. The F-16 SPO engineering official who approved contractor recommendations for Westinghouse support equipment said he relied on Ogden officials to review the contractor recommendations and did not participate in the depot review process because of the small number of items and the relatively low-dollar amount involved.

PRICE CONTROL OPPORTUNITIES WERE LOST

The procurement process has several features which are intended to insure the reasonableness of prices. These features did not work in this procurement.

Air Force Systems Command regulations specifically prohibit use of unpriced modifications, except in urgent situations. While the decision to issue the unpriced modification in this case implied urgency of the requirement, the extent of that urgency is questionable since 15 of the items were ordered in September 1982 to support the Air Force's repair of the antennas which was not scheduled to begin until late in 1984. As of July 1985, Ogden had not started repairing antennas.

Contracting officers are required by these regulations to negotiate a firm price within 180 days of approval of an unpriced modification. The regulations provide that after-the-fact pricing will always be avoided. The use of unpriced modifications puts the government in the unfavorable position of having to accept costs incurred by the contractor to perform under the unpriced modifications unless the government can demonstrate the unreasonableness of the price. In the absence of competition, negotiating a price in advance is the preferred method of contracting since it places the government in a stronger position to ascertain whether the prices are fair and reasonable. In the context of this procurement, negotiating a price before authorizing work to be performed would have allowed the contracting officer to consider, through negotiation, whether $8,832 was a fair and reasonable price for a pulley puller.

In this case, and contrary to regulatory requirements, the prices were not negotiated for about 13 to 20 months after the date of the unpriced modification. Negotiations with General Dynamics for the items manufactured by General Dynamics and subcontractors other than Westinghouse were completed in October 1983 and negotiations for the Westinghouse manufactured items were completed in May 1984. The Westinghouse items took the longest to negotiate and all but one item had been manufactured and delivered by the time final prices were negotiated. Thus, the final prices agreed to were substantially determined by the costs claimed by the prime contractor and subcontractors, plus overhead and profit.

In authorizing General Dynamics to proceed with support equipment development without pricing the items, the Air Force compromised its right to challenge the reasonableness of item prices. Instead of being in a position to negotiate fair and reasonable prices, the Air Force was virtually faced with accepting actual costs the contractors incurred. Decisions of the Armed Services Board of Contract Appeals and federal courts have consistently held that contractor-incurred costs are presumed to be reasonable, and, if the government desires to challenge such costs, it has the burden of proving that the costs are unreasonable. As a general rule, as long as a contractor can present a reasonable rationale justifying the incurred costs, it is extremely difficult for the government to successfully challenge the costs. For this reason, the instruction to contracting officers to avoid the use of unpriced modifications, absent some urgency, is well founded.

The procurement process included a review of price proposals by the Defense Contract Audit Agency and the Air Force Plant Representative Office. In this case, both organizations raised concerns about the prices for the items. Defense Contract Audit Agency conclusions dealt with the tentative nature of vendor quotes from Westinghouse and a general observation that 11 percent price reductions should be achieved from the subcontractor. However, the Defense Contract Audit Agency concluded that the General Dynamics proposal was acceptable as a basis for negotiation.

The Air Force Plant Representative Office raised questions about the reasonableness of the prices of the Westinghouse items and recommended that the items be bought directly from Westinghouse or through local manufacture. In April 1983 the Air Force Plant Representative Office sent a letter to General Dynamics stating that the prices to the Air Force for single piece items were in the $9,000 to $11,000 category which, from all appearances, should have been priced between $2 and $150. The letter also stated that the assemblies were priced between $13,000 and

$28,000 which, on the surface, should have been in the $200 to $500 range.

After the Plant Representative Office's letter, General Dynamics wrote Westinghouse in June 1983 and strongly recommended that Westinghouse reevaluate the prices proposed for the items. Later that month Westinghouse advised General Dynamics that simplicity of the item does not dictate costs, but that requirements do. Westinghouse told General Dynamics to reexamine its requirements on any of the items and eliminate some and Westinghouse would delete commensurate costs, as appropriate. In November 1983, before the price negotiation period, significant questions were raised about the reasonableness of the proposed prices for the Westinghouse items in a congressional hearing.[2] In response to the hearing, the Air Force stated that the prices for the Westinghouse items would be vigorously reviewed and negotiated.

Subsequently, the F-16 SPO designated four items for local manufacture and bought engineering drawings only for $176. The four items were locally manufactured by the Air Force and the SPO was billed $995 for the items. In contrast, General Dynamics had proposed a total price of $41,514 for the four items, or a difference of $40,519. However, we found no evidence that local manufacture was considered for the remaining eight noncomplex items. Furthermore, negotiations for these items resulted in the General Dynamics proposed price being reduced from $254,707 to $249,462, a reduction of $5,245, or 2.1 percent.

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[2] Senate Hearing before the Committee on Governmental Affairs on purchasing of spare parts and support equipment, 98th Cong., 1st Sess., pt. 6 (1983).

Although public pressure and controversy had an impact on prices finally paid for some items, the final negotiated prices for many of the noncomplex items do not reflect their intrinsic value. The Air Force Plant Representative Office at General Dynamics recognized this situation early in the procurement process and so advised General Dynamics and Air Force procurement officials at the F-16 SPO. Why the F-16 procurement officials did not follow the Plant Representative Office's recommendations is not clear, but the fact that substantial costs had been incurred by the contractor apparently was an overriding reason to continue with the procurement.

PROBLEMS IN CONTRACTOR COST RECORDING

We reviewed cost records related to this procurement at General Dynamics and Westinghouse. At General Dynamics, three of the equipment items manufactured by General Dynamics met the monetary threshold to be assigned unique work orders so that costs were recorded and traceable at the individual item level. For the remaining equipment items, composite work orders were assigned which commingled the costs of the items. We tested labor and material charges recorded for two of the three unique work orders and found errors in both direct labor charges and direct material charges. Similar cost charging errors were also identified on a broader basis in two previous reports on General Dynamics' cost accounting practices.[3]

Our review revealed that two items manufactured by General Dynamics (both radar boresight fixtures) were defectively priced. The defective price occurred because General Dynamics proposed and negotiated material prices based on noncurrent purchase orders. General Dynamics has proposed a reduction in the price for these items of $30,858 in response to our finding.

We also identified 359 engineering hours recorded by General Dynamics for work related to the Westinghouse items, but General Dynamics purposely excluded the costs for these hours from the final price proposal and negotiated price. However, General Dynamics routinely records such engineering hours in cost records which are used as a basis for progress payments by the Air Force on the F-16 contract, and these 359 engineering hours had been so recorded. Therefore, the Air Force could end up paying the costs for these hours even though they were excluded from the proposed and negotiated price. After we brought this matter to General Dynamics' attention, $11,700, the amount involved, was transferred from the cost accounts for progress payments to an unallowable account so as to preclude future payments.

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[3] Audit Report on Comprehensive Review of Labor Charging Practices at General Dynamics, Fort Worth Division, Defense Contract Audit Agency (May 6, 1985, Report No. 1361-5E-130-104).

Joint Cost Monitoring Review of Support Equipment Manufacturing Activities, General Dynamics, Fort Worth Division, Defense Contract Audit Agency and Air Force Plant Representative's Office (January 30, 1984, Report No. 27/1361-AU-83-02).

At Westinghouse, we tested summary records by tracing over 50 percent of labor and material costs to subsidiary records, purchase orders, and invoices. While our review of records disclosed that the charges were accurately recorded and they supported Westinghouse cost records, the fact that most of the items already existed and were in use in the repair and manufacture of radar antennas at Westinghouse raises significant questions. One question concerns the government incurring these costs when it had already paid for the earlier development and manufacture of like items. We asked Westinghouse about the number, source, and financing of these earlier items. We were informed that they had been developed under a "tooling" line in a previous purchase order which did not require part-by-part break-out or data retention. Therefore, Westinghouse could not identify how many items were in existence or what their original cost to the government might have been. Under the purchase order, Westinghouse retained title to the tooling.

In addition, examination of the complexity (or non-complexity) of some of the Westinghouse items raises further questions about whether the kind of costs recorded are consistent with a realistic assessment of design requirements. For example, prior to the decision to buy drawings for the alignment pins, Westinghouse recorded 63 hours of engineering effort on the pin. It is difficult to understand how this level of effort was required when an Ogden technician was able to make a suitable alternative alignment pin in minutes from stock materials.

OBSERVATIONS ABOUT SPECIFIC EQUIPMENT ITEMS

Our review revealed a number of anomalies concerning specific items in this procurement which raise significant questions about the thoroughness of the Air Force's or General Dynamics' consideration and evaluation of need, value, source and utilization.

General Dynamics recommended the purchase of an antenna motor brush assembly tool at a price of $10,624, for use in repair of the antenna. However, Westinghouse does not use such a tool in conducting the repair function. Instead, Westinghouse uses a 3 by 8 inch sheet of flexible plastic.

General Dynamics also recommended the purchase of two metal antenna motor assembly alignment pins for $9,376. Although the Air Force subsequently bought only the drawings for the item for $44, and manufactured two pins for $91, we were told that Westinghouse uses wooden sticks to perform the function the alignment pins were designed to perform. A technician at Ogden told us that, before the alignment pins were received, he cut two pieces of wire from stock material which he used as alignment pins. In a similar instance, a hexagon antenna wrench was proposed by General Dynamics for procurement at $9,609. The Air Force subsequently bought the drawings for $44 and made two wrenches for $211. Before a wrench was received at Ogden, a technician made a similar tool from a commercial wrench for his use. We were told that in both instances the locally made items worked satisfactorily. The technician used these two tools on an antenna at the depot as part of his validation of the technical order for antenna repair.

General Dynamics procured the vacuum/heat maintenance stand from Westinghouse for which the Air Force paid $163,843. However, the Westinghouse Electronic Repair Center repairs antennas without a stand. The maintenance stand was manufactured and delivered to Ogden in August of 1984. As of July 1985, it was still stored unused at Ogden, because they had not yet received a technical order showing how to use it.

In September 1984, the Secretary of the Air Force sent a letter to numerous major defense suppliers in which he cited the pulley puller as an example of a tool that cost too much. He stated that the Air Force paid $8,832 for the pulley puller which should cost only a few dollars and that Air Force applied for and received a refund (General Dynamics lowered the price to $370 and gave the Air Force a refund of $8,462). The Secretary also stated that the Air Force should have noted the exorbitant price before ordering, but that responsibility for the price is shared equally with those who set the price in the first place.

The pulley puller delivered to Ogden has a bolt head requiring a screwdriver rather than a wrench. The technician demonstrated to us that he cannot get enough torque with a screwdriver to use the tool as intended. This error occurred despite the fact that General Dynamics is contractually required to test and ensure performance of support equipment provided under its contract.

We noted that General Dynamics recommended two items, the antenna tape block tool and the antenna clamp alignment tool, that were similar to each other and designed to perform the same function. The latter tool was cancelled, but not until after both had been approved as needed by Ogden and the SPO.

Finally, the inflight refueling adapter, procured from General Dynamics for $3,626, was shipped to the San Antonio Air Logistics Center in January 1984. Although San Antonio records show that the item was received, it is now lost. We also found that this item appeared on a San Antonio list of excess property in June 1985 so, if it is found, the possibility exists that it would be disposed of.

RESPONSIBILITY FOR THE ACQUISITION

We were asked, in undertaking this work, to determine responsibility for the acquisition of these support equipment items and their resulting cost to the Air Force. As in the case of any acquisition action, responsibility lies at several levels.

Our review raises serious questions about the performance in this case of the General Dynamics Corporation under its F-16 aircraft contract obligation to identify and recommend procurement only of needed support equipment items through the most cost-effective method. It also raises questions about the decision to design and manufacture simple tools as newly designed, one-of-a-kind items when some of the tools were not being used by Westinghouse and others were in routine use in its ongoing manufacture and repair operations.

Our review calls into question the performance of the F-16 SPO in its responsibilities to review and approve support equipment recommendations with careful consideration to matters of need, value, and price. We also identified a serious lack of communication between the SPO and Ogden concerning Ogden's responsibilities for concurrence in the procurement of the items.

In a broader sense, our review calls into question many aspects of the system of acquisition which relies on thoughtful consideration of need, value, and price, but which, at least in this instance, operated as a mechanical process of approving contractor recommendations.

RECENT AIR FORCE INITIATIVES

SPO officials advised us that they established a Support Equipment Review Board in January 1984 to more effectively evaluate need, prices, and sources for support equipment. The Board makes two reviews of each new proposed support equipment item; the first review concerns need and acquisition method and the second review concerns prices. According to these officials, the new procedures from January 1984 to May 1985 have contributed to savings of $3.4 million on work completed and another $1.7 million savings is estimated on work still in process.

In addition, the Air Force Plant Representative Office at General Dynamics and Westinghouse have established contract proposal screening processes for support equipment. Responsibility for negotiating prices for support equipment for the F-16 has been transferred from the SPO to the Plant Representative Office at General Dynamics, to obtain more effective face-to-face negotiations of prices.

We asked SPO officials whether their new procedures would have avoided the problems we identified had they been in place at the time. Using the eight Westinghouse items as an illustration they said that it is not certain that the new procedures would have produced a better result. A procurement which started with the issuance of an unpriced contract modification, as this one did, would face many, if not all, of the risks and problems which occurred here despite the opportunities for Support Equipment Review Board analysis.

In discussing the facts we developed with Air Force officials they emphasized that this review involved an old procurement action, and that new procedures have been implemented to address the problems cited. They also cautioned that urgent military requirements sometimes mandate unpriced acquisition procedures, despite the risks of these procedures, to insure that defense objectives can be met. We will examine implementation of any new procedures in connection with our recently initiated review of the Department of Defense's use of unpriced contract agreements.

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This concludes my statement, Mr. Chairman. We would be pleased to respond to any questions the Subcommittee might have.

Mr. **Dingell**. Mr. Conahan, the subcommittee thanks you for your very helpful comments.

Mr. Quicksall, do you have any comments you would like to add?

Mr. **Quicksall**. No, sir, I do not have an opening statement.

Mr. **Dingell**. The Chair does wish to express the appreciation of the subcommittee to each of you gentleman, and also to all of your associates who worked on that matter.

The Chair is particularly anxious that you be aware of this, but the Chair would like to extend his comments to Mr. Seth Taylor, whom I believe also participated in this inquiry in an extraordinary fashion, and we hope that the necessary commendations on his service and personnel record will be included, because we believe that his service was well beyond what could be ordinarily expected. As a matter of fact, his performance, as the performance of each of you gentlemen, and your associates at GAO, was extraordinary.

Gentlemen, the Chair has some questions here.

Mr. Quicksall, your experience in defense contracting extends over what period of time?

TESTIMONY OF JOE D. QUICKSALL

Mr. **Quicksall**. I have been auditing defense contracts for over 20 years.

Mr. **Dingell**. Did you interview the Westinghouse engineers?

Mr. **Quicksall**. I did not.

Mr. **Dingell**. Please explain why not?

Mr. **Quicksall**. At Westinghouse they follow a procedure whereby we are not allowed to interview their employees.

Mr. **Dingell**. You are not?

Mr. **Quicksall**. We are not.

Mr. **Dingell**. Even though they are, in fact, a defense contractor?

Mr. **Quicksall**. Yes, sir.

Mr. **Dingell**. How did you obtain the information from Westinghouse?

Mr. **Quicksall**. We submitted questions in writing and received answers in writing. On two or three occasions we tried to interview people and those interviews were stopped. We were told the Westinghouse employees could not answer questions, and that the questions had to be submitted in writing.

Mr. **Dingell**. Will you submit to this subcommittee a list of all persons who informed you that you were not permitted to interview personnel at Westinghouse, and the names of all persons you sought to inteview whose interview was precluded to you by reason of Westinghouse's policy?

Mr. **Quicksall**. Could I submit that for the record, sir?

[The information follows:]

We were told by Mr. Charles Gildea that Westinghouse Corporation policy was to entertain questions in writing and respond to those questions in writing and that interviews would not be permitted. We have determined that interviews with the following individuals would be in order: A.P. Dagher; O.T. Davies; S.D. Davis; D.P. Hunt; J.D. Kernan; C.D. Ketchum; B.L. Moore; L. Paxton, Jr.; V.E. Spears; and R.H. Trimble.

Mr. **Dingell**. Yes, sir, not at this time but for the record.

Mr. Quicksell, did this inhibit your work?

Mr. **Quicksall**. Yes, sir. Because we had to submit written questions and receive written answers, we never were sure who was answering the question.

We were told that the corporate attorneys at Westinghouse wanted it that way, and therefore we didn't know whether the engineers were answering the questions or the corporate attorneys.

Mr. **Dingell**. Mr. Quicksall, in your report you noted that the Westinghouse engineers charged 63 hours, primarily the design engineer, of the effort on the alignment pin. This is referred to on page 34 of the appendix of the GAO report.

Can you explain this action?

Mr. **Quicksall**. No, sir; I cannot. I cannot explain how it took that many hours to design the pin; if I understand the question.

Mr. **Dingell**. Why is it that you were not able to tell us this morning about why it took 63 hours?

Mr. **Quicksall**. We would need to interview the engineers who charged that time, both the design engineer and the other engineers.

Mr. **Dingell**. I am sure that on conclusion of today's inquiries that you will have cooperation from Westinghouse.

Mr. **Quicksall**. Thank you, sir.

Mr. **Dingell**. I believe that you will probably achieve the early understanding of those facts through the cooperative efforts of Westinghouse.

Were these actual booked charges?

Mr. **Quicksall**. Yes, sir, these were actual charges by engineers by name, by social security number.

Mr. **Dingell**. Is Mr. Graham in the room?

Mr. Graham, do you have that splendid 3-inch piece of wire?

Mr. **Graham**. No, I do not.

Mr. **Dingell**. We understood you were going to bring a tool box with you this morning.

Did you bring your toolbox?

Mr. **Graham**. That was not one of the items on the agenda.

Mr. **Dingell**. Is your toolbox in town?

Mr. **Graham**. I had some things sent up here, yes.

Mr. **Dingell**. You were directed, I believe, that you were to have your toolbox, including that wonderful piece of wire, available.

You were not?

We will pursue that in greater detail at another time.

You did say you sent some things up here?

Mr. **Graham**. Yes, sir.

Mr. **Dingell**. Where did you send those things? Did you send them to the Air Force, or to the subcommittee?

Mr. **Graham**. Evidently they are up here.

Mr. **Dingell**. You sent them to the subcommittee or to the Air Force?

Mr. **Graham**. They were hand carried up here.

Mr. **Dingell**. To where?

General **Monahan**. Mr. Chairman, we have the tools right here, Mr. Chairman.

Mr. **Dingell**. Would you please submit them to the subcommittee?

I can understand the reluctance of the Air Force to make these tools available.

General **Yates**. The tools are contained here, Mr. Chairman.

Mr. **Dingell**. Perhaps the officer who opened those, or you, Mr. Graham, could get in there and find that 3-inch pin. We would like to look at that and inquire of the GAO about that.

General **Yates**. We did not bring the 3-inch pin because the Air Force did not buy the 3-inch pin from General Dynamics, so, therefore, we didn't bring it to this hearing.

Mr. **Dingell**. Did you make it?

General **Yates**. The Air Force made the pin; that is correct, sir.

Mr. **Dingell**. I am sorry we don't have it, but maybe Mr. Quicksall you could assist the subcommittee by telling us how an engineer would need 63 hours to design a simple 3-inch pin?

Can you tell us how that is done?

Mr. **Quicksall**. Sir; I cannot tell you. On page 34 of the report is a picture of the 3-inch pin and a picture of another pin made by the Air Force. I cannot explain how long it took to design that pin.

Mr. **Wyden**. Would the chairman yield?

Mr. **Dingell**. Yes.

Mr. **Wyden**. If I might ask Mr. Graham; Mr. Graham, couldn't you make a 3-inch piece of wire right here for us?

Mr. **Graham**. No, I couldn't.

Mr. **Wyden**. You could not?

My understanding is you told the GAO you could make it out of a coat hanger.

Mr. **Graham**. But I don't have a coat hanger here.

Mr. **Wyden**. I understand perfectly, and certainly we can supply you with a coat hanger if we decide to go that route, Mr. Graham. I appreciate your candor.

Thank you, Mr. Chairman.

Mr. **Dingell**. Mr. Quicksall, did you interview the engineer that charged the time to this piece of wire?

Mr. **Quicksall**. Excuse me, sir. The pin, the Westinghouse pin, we did not interview any engineers at Westinghouse.

Mr. **Dingell**. Can you inform us why?

Mr. **Quicksall**. We were told that we would not be able to interview. All questions had to be submitted in writing, and all answers would be made in writing.

Mr. **Dingell**. Were you informed of anything else about the particular engineer at the time that you made the inquiry about interviewing that particular engineer?

Mr. **Quicksall**. From the record we can identify the engineers by name, and social security number, who charged time to this particular item.

Mr. **Dingell**. Would you submit that for the record, please?

Mr. **Quicksall**. Yes, sir.

[The information follows:]

The following Westinghouse Corporation engineers charged time on the alignment pin: D.P. Hunt; C.H. Jackson, Jr.; M.J. Ames; R.H. Trimble; O.T. Davies; C.D. Ketchum; and D.L. Chojnacki.

Mr. **Dingell**. Mr. Quicksall, we understand that General Dynamics had initially proposed 62 engineering hours for the Westinghouse alignment pin. Is that correct?

Mr. **Quicksall**. Yes, sir, that is correct.

Mr. **Dingell**. Mr. Quicksall, it may be that we have sort of figured this problem out. Westinghouse charged 63 hours of engineering time, while General Dynamics charged only 62 hours to supervise.

Is that correct?

Mr. **Quicksall**. Yes, sir; that is correct.

Mr. **Dingell**. So General Dynamics charged 62 hours of engineering time for supervision of Westinghouse, on the 63 hours of engineering time that Westinghouse put into this matter; is that correct?

Mr. **Quicksall**. General Dynamics proposed the 62 hours. They did not finally charge 62 hours.

Mr. **Dingell**. What did they charge?

Mr. **Quicksall**. We are unable to tell from the record exactly how many hours were charged to individual items.

Mr. **Dingell**. Could I infer that the Westinghouse engineer transformed a wooden stick into a $14,000 3-inch piece of wire during this unsupervised hour?

Mr. **Quicksall**. You could, sir.

Mr. **Dingell**. Is that a fair inference?

Mr. **Quicksall**. The Westinghouse engineer who overhauls this motor uses wooden sticks.

Mr. **Dingell**. You say that Westinghouse uses a wooden stick to perform the work for which the wire pin will be used, is that correct?

Mr. **Quicksall**. Yes.

Mr. **Dingell**. Now, Mr. Quicksall, on page 3 of the GAO report you state that different numbers were assigned to the Westinghouse tools, which tools were recommended to the Air Force, and I believe you have provided the Subcommittee with a listing of the switch numbers, and the specific one; is that correct?

Mr. **Quicksall**. Yes, sir.

Mr. **Dingell**. Can you inform the subcommittee what those numbers represent?

Mr. **Quicksall**. The paper that those numbers appear on say that they are part numbers. At a conference with Westinghouse employees we asked them what those numbers were. One Westinghouse employee suggested that they might be sketch numbers.

Mr. **Dingell**. They might be what?

Mr. **Quicksall**. Sketch numbers.

Mr. **Dingell**. Sketch numbers.

Mr. **Quicksall**. Yes. At that time the Westinghouse employee in charge of the meeting said all questions would have to be submitted in writing, and all answers would be provided in writing.

Mr. **Dingell**. That terminated the interview at that point?

Mr. **Quicksall**. We continued the conversation, but we didn't talk about the part numbers. We submitted a question as to what those part numbers were and were told that they represented sketches of Westinghouse's original tools.

Mr. **Dingell**. How did you learn this information?

Mr. **Quicksall**. We found the part numbers, the two sets of part numbers, in General Dynamics records in Fort Worth.

Mr. **Dingell**. You found them in General Dynamics records?

Mr. **Quicksall.** Yes, sir.

Mr. **Dingell.** It is curious, you were interviewing Westinghouse but you get the information from the records of General Dynamics.

Mr. **Quicksall.** We had gone to Westinghouse to ask that question of Westinghouse.

Mr. **Dingell.** But you didn't get an answer from Westinghouse?

Mr. **Quicksall.** We asked the question, and they responded that the numbers on the Westinghouse tools represented sketches for drawings of the original Westinghouse tools.

Mr. **Dingell.** At that time, you were told to submit questions in writing. Were Westinghouse employees silenced by their supervisors in any way?

Mr. **Quicksall.** Yes.

Mr. **Dingell** Please describe that.

Mr. **Quicksall** There were three Westinghouse employees in the room and the lead Westinghouse employee told the other not to respond to any further questions.

Mr. **Dingell.** He said that?

Mr. **Quicksall.** Yes, sir.

Mr. **Dingell.** What was his name?

Mr. **Quicksall.** Gildea; Charles Gildea.

Mr. **Dingell.** Did he explain why he was doing that?

Mr. **Quicksall.** He told us that it was the policy of Westinghouse. Their corporate attorneys did not want us to interview Westinghouse employees.

Mr. **Dingell.** Can you tell us whether the numbers were the same on these tools in all instances; or were they different?

Mr. **Quicksall.** The tools used by Westinghouse have different numbers on them than the tools sent to the Air Force.

Mr. **Dingell.** Why was this so?

Did Westinghouse tell you why the new numbers were assigned?

Mr. **Quicksall.** The new numbers were assigned so that they could have Air Force drawings for the tools.

Mr. **Dingell.** What does that mean?

Mr. **Quicksall.** Sir, I don't know for sure. I believe that means that the pin or the wooden sticks that were used by Westinghouse, they were making a new part for the Air Force and it would be a metal pin, and that metal pin would have a part number for the Air Force.

Mr. **Dingell.** Had Westinghouse already made drawings of an earlier set of tools; manufactured the tools and used the tools to repair radar antennas for a period of 5 years?

Mr. **Quicksall.** Yes, sir, they had made the tools and used the tools for several years to repair radars.

Mr. **Dingell.** Five years?

Mr. **Quicksall.** Several years. We were never able to determine how many years the tools had been in existence.

Mr. **Dingell.** Then Westinghouse made new drawings of the tools?

Mr. **Quicksall.** Yes, sir.

Mr. **Dingell.** They tested the tools for compatibility to see whether they would work?

Mr. **Quicksall.** They tested the Air Force tools for compatibility. There own tools had been used to repair radars for several years.

Mr. Dingell. Would you call that double billing?

Mr. Quicksall. The Air Force paid for the tools made by Westinghouse, and it also paid for the tools made for the Air Force.

Mr. Dingell. So, they paid twice for the same tools?

Mr. Quicksall. They paid twice.

Mr. Dingell. They paid twice for the same development work?

Mr. Quicksall. They paid twice for two sets of drawings and two sets of tools.

Mr. Dingell. Two sets of development work?

Mr. Quicksall. Yes, sir.

Mr. Conahan. Mr. Chairman, I would like to say that they did pay for two sets of drawings and two sets of tools, but they didn't pay twice for the same set. I think that that is important. It is for the same function.

Mr. Dingell. I think that is a fair point; but the tools did exactly the same work?

Mr. Conahan. The same function, yes, sir.

Mr. Dingell. Mr. Quicksall, you have seen the tools, and I believe you have handled them and watched them used. Is it possible that the tools could have been manufactured locally?

Mr. Quicksall. Yes, sir.

Mr. Dingell. They could have been manufactured at an Air Force installation?

Mr. Quicksall. They could be manufactured in machine shops. They were, in fact, manufactured in machine shops.

Mr. Dingell. One of the tools used by Westinghouse to repair the radar antenna was a 3- by 8-inch plastic sheet. Please explain what this item was, and then tell the subcommittee what Westinghouse sold to the Federal Government as a replacement for this 3- by 8-inch plastic sheet.

Mr. Quicksall. We asked Westinghouse for a demonstration of the tools and a walk-through of their repair facility. The Westinghouse engineer who repairs the radars was demonstrating the tools to us.

We asked him where the brush assembly tool was; and he said he did not have a brush assembly tool. We asked him how he performed that function; and he indicated a piece of plastic sheet in his toolbox and said that is how he performed the function of keeping the brushes off the motor when he repaired the motor.

Mr. Dingell. What is the cost of that item?

Mr. Quicksall. Sir, I don't know. It is a piece of plastic about 3 inches across and about 8 inches long, similar to a piece of plastic you might cut of out of a milk jug or bleach bottle.

Mr. Dingell. What did the Federal Government pay for the tool that Westinghouse manufactured or designed for the Federal Government when the Federal Government procured the tool?

Mr. Quicksall. That tool is the brush assembly tool and the precise figure is in the report, but it is about $10,000.

Mr. Dingell. I gather it was about $10,000?

Mr. Quicksall. About $10,000.

Just a moment, sir.

Mr. Wyden. Mr. Chairman——

Mr. Quicksall, isn't the exact price $10,624?

Mr. Quicksall. That is correct.

Mr. **Wyden**. Thank you, Mr. Chairman.

Mr. **Dingell**. Now, Mr. Quicksall, you said that DCAA in its audit found these items were overpriced by about 11 percent. I believe, however, that some of these items were overpriced by a factor of as much as 10,000 times.

What is the difference between these two figures; and how did this event occur?

Mr. **Quicksall**. The DCAA or the Defense Contract Audit Agency report is based on telephone quotes from Westinghouse.

Mr. **Dingell**. On telephone quotes?

Mr. **Quicksall**. Yes, sir.

Mr. **Dingell**. Did they ever look at the parts or make any inquiry on the matters?

Mr. **Quicksall**. They did not look at the parts. The telephone quotes are single prices for each item, and there is no breakdown of cost.

Mr. **Dingell**. How much of this item was based on the quote "telephone quotes"?

Mr. **Quicksall**. The total proposal was about $1.2 million, and over half of that proposal was based on telephone quotes.

Mr. **Dingell**. What are telephone quotes, and how much contracting does the Department of Defense do over the telephone?

Mr. **Quicksall**. A telephone quote is simply a quote that is provided by telephone, that is a single price for an item. I am not prepared to say how much business they do by telephone, but it is a common practice to receive telephone quotes, particularly when dealing with subcontractors.

Mr. **Dingell**. As I observe it, a telephone quote then is a price given by telephone?

Mr. **Quicksall**. Yes, sir.

Mr. **Dingell**. It is a common practice in dealing with subcontractors?

Mr. **Quicksall**. Yes, sir.

Mr. **Dingell**. Are telephone quotes adequate to protect taxpayers?

Mr. **Quicksall**. The DCAA will accept telephone quotes. However, from an audit standpoint, a telephone quote, no audit can be made of it. It is a single price.

There is no breakdown of how the costs are arrived at or what is involved, whether it is engineering, labor, materials or what.

Mr. **Dingell**. So literally on a telephone quote there is no paper and there are no supporting documents to ascertain whether, in fact, the taxpayers are protected; the costs are proper; the charges against the Federal Government comport either with law, or with the costs that are faced by the contractor; is that correct?

Mr. **Quicksall**. The telephone quotes are usually confirmed in writing, which is simply putting the number on a piece of paper.

Mr. **Dingell**. How does one then audit that kind of transaction?

Mr. **Quicksall**. That transaction cannot be audited.

Mr. **Dingell**. It cannot be audited?

Mr. **Quicksall**. Not the single number. You must have a cost breakdown to know how many engineering hours or how much material is going to be charged.

Mr. DINGELL. How many of these are attended by a later submission of a cost breakdown?

Mr. QUICKSALL. There will be a cost breakdown submitted at some time in the future, but under an unpriced order the contractor is authorized to begin work.

Mr. DINGELL. The courts have held that it is very difficult for the Federal Government to retrieve overcharges or even to identify overcharges under this an arrangement; is that correct?

Mr. QUICKSALL. Yes, sir. The courts hold that the burden of proof is on the Government in such an arrangement.

Mr. DINGELL. It is a very heavy burden?

Mr. QUICKSALL. Yes, sir.

Mr. DINGELL. The Chair has used more time than is appropriate. In view of that, the Chair will adjust the times of other members.

The Chair recognizes, first, the gentleman from Oregon, Mr. Wyden.

Mr. WYDEN. Thank you very much.

Mr. Quicksall, I guess the question, following up on the Chairman, is: Why in the world did the Air Force use these telephone quotes so extensively? You say they can't be audited. It certainly doesn't seem to protect the taxpayers.

Is this just another example of so-called speedy procurement and to heck with the price?

Mr. QUICKSALL. The telephone quote is a way to get a speedy answer to the question of price.

Mr. WYDEN. I am sorry. I couldn't hear you.

Mr. QUICKSALL. The telephone quote is a way to get a speedy answer to the question of price.

Mr. WYDEN. On page 2 of your report, you say approval of the unpriced order was the critical action in acquisition. From your description of the results of the unpriced orders, it sounds literally like a license to steal.

Is that correct?

Mr. QUICKSALL. The unpriced order authorizes the contractor to begin incurring costs. Under the rules, it should be reduced to a price in 180 days. If it is not reduced to a final price in 180 days, you end up paying costs. The longer it goes, the more costs are incurred.

Mr. WYDEN. Why does the Air Force use this type of contract?

Mr. QUICKSALL. It can be quickly done.

Mr. WYDEN. What happens after the 180-day period?

Mr. QUICKSALL. Well, there is no provision to stop the order at the end of 180 days. The contractor continues to incur costs.

Mr. WYDEN. As I understand it, in this case the unpriced order continued for about 20 months?

Mr. QUICKSALL. Yes, sir; 13 to 20 months before prices were determined.

Mr. WYDEN. Well, isn't this then a cost plus percentage of cost contracting, and also a process that is illegal?

Mr. QUICKSALL. Cost plus percentage of cost contracts are illegal, and from a common sense perspective these may appear to be that. They are not legally cost plus percentage of cost contracts.

Mr. **Wyden**. The GAO is certainly concerned about the widespread use of unpriced orders, is it not? It puts the Government in an unfavorable position.

Mr. **Quicksall**. Yes, sir.

Mr. **Conahan**. Perhaps I could comment, Mr. Wyden.

Not only are we concerned with it, but over the past several months we have extended a review into a number of defense contractors taking a look at just how widespread the practice is, and the extent to which this is impacting on excessive prices being paid by the Government.

Mr. **Wyden**. Mr. Conahan, on page 5 of your report you state that the extent of the so-called urgency in this case is very questionable since the Air Force tools still have not been used to repair radar antennas, even though it is 3 years after the tools were ordered.

What, in fact, was the urgency? Could your agency determine one?

Mr. **Conahan**. No, sir. And, as a matter of fact, I think that the question of urgency needs to be looked at at the time the decision was made. That decision was made in September 1982. At that time, it was projected that the repair work would not be done until late 1984, or some 2 years later.

It seems to us there was ample time to use a different kind of procurement instrument than one which permits the kind of activity that we have seen here on this one.

Mr. **Wyden**. You made it clear that you didn't think that this was urgent procurement. Is there any evidence in the record that this was an urgent procurement?

Mr. **Conahan**. There is an assertion in the record that it is an urgent——

Mr. **Wyden**. That is different than the evidence.

Mr. **Conahan**. We have found no evidence to underlie that assertion.

Mr. **Wyden**. You found no evidence that would support the assertion?

Mr. **Conahan**. Right, sir.

Mr. **Wyden**. Mr. Conahan, in your report you mentioned Air Force regulations require unpriced contracts to be definitized within 180 days. However, the subject unpriced order took 13 to 20 months to negotiate.

Is this unusual for the Air Force not to meet the 180-day deadline?

Mr. **Conahan**. No, sir. Unfortunately, it seems to be all too frequently the case. It is our understanding that there are large numbers of unpriced orders that have not been definitized long after 180 days.

Mr. **Wyden**. Why was it not made definite within the 180 days, Mr. Conahan?

Mr. **Conahan**. I think there are a number of factors involved in that. I think that the Air Force itself, or people within the Air Force, raised questions about the reasonableness of the price. That involved a dialog between the contractors and the Air Force. Then, after that, there was congressional inquiry into it, and I think that had a bit to do with it, for the good, as a matter of fact, because beginning at that time some sensible decisions were being made.

I think that what we had in the early days was a situation where attention—the kind of attention needed to be devoted to this—simply was not; no one in the Air Force is called on the carpet, so to speak, for not proceeding more deliberately in these matters. And it simply is a matter of routine.

Mr. **Wyden**. What you are saying is that the Air Force, in effect, ends up—because of the fact that the 180-day deadline was never met—the Air Force basically pays the price without having a say in what the price is.

Would you say that is a fair analysis of the situation?

Mr. **Conahan**. I would say it is very, very difficult for the Air Force not to pay prices that have already been incurred. The burden of proof of unreasonableness is on the part of the Air Force, and that is just an extremely difficult thing to do.

Mr. **Wyden**. If the unpriced orders put the Government in such a clear price disadvantage, why is the Air Force continuing to use this process? Isn't it a signal, in effect, that the Air Force really doesn't care about the price?

Mr. **Conahan**. There is clearly a trend toward increased use of unpriced orders, and I should think that were I a contractor I would interpret that as a move on the part of the Air Force to permit an increased use of that form of contracting.

Mr. **Wyden**. Just to make it clear—I cited it and I believe the chairman did—unpriced orders are growing in their use, and it is our understanding that the Air Force—between 1983 and September 30, 1984, the amount went from almost $6 billion to almost $11 billion.

Is that correct?

Mr. **Conahan**. Yes, sir.

Mr. **Wyden**. Mr. Quicksall, we have also received data that as of last week the McDonnell Douglas Corporation has over $1 billion in unpriced orders out.

Is that correct?

Mr. **Quicksall**. That would be a correct figure, sir.

Mr. **Wyden**. Mr. Quicksall, how many dollars of unpriced orders does Westinghouse Corporation have, and how many of them are older than 180 days?

Mr. **Quicksall**. They have over $130 million in unpriced orders as of 2 weeks ago, and over $100 million of them were over 180 days.

Mr. **Wyden**. That is on the order of about 80 percent, then?

Mr. **Quicksall**. Yes, sir.

Mr. **Wyden**. On the basis of your extensive experience, Mr. Quicksall, do you think that the horror stories you have pointed out are all that unusual when we are dealing with unpriced orders?

Mr. **Quicksall**. An unpriced order does give the contractor the right to incur costs, and under those types of arrangements you are likely to find a large number of horror stories.

Mr. **Conahan**. I think, Mr. Wyden, one needs to take a look at the caveat that is in our report. This is a one-time transaction that GAO reviewed. And insofar as documented evidence on the part of

GAO, at the moment we are coming to this. We hope to be able to bring to this committee and others the results of a much wider review.

Mr. **Wyden**. Mr. Quicksall, the subcommittee staff recently interviewed a Pentagon official who attended a high level meeting with some of the Secretary's top people—Secretary Weinberger. He said the No. 1 management issue facing the Pentagon today is that they have fallen $20 billion behind in obligating available funds.

The directive at this particular meeting was to get the money obligated and get back on schedule.

Aren't unpriced orders in fact today the main vehicle to accomplish this very peculiar business or mission?

Mr. **Quicksall**. Unpriced orders are certainly a vehicle that will get contracts on the street in 1 day.

Mr. **Wyden**. You said that not only can they get the money out the door quickly, this is the way to get it on the street in 1 day?

Mr. **Quicksall**. Yes, sir. The unpriced order we looked at was approved on the 20th of September, and the contractor was authorized to go ahead the following day, the 21st.

Mr. **Wyden**. Mr. Quicksall, could you explain the two cases of defective pricing that you discovered during the investigation? We are particularly interested in knowing how the Air Force and DCAA somehow managed to miss these.

Mr. **Quicksall**. I guess the simple answer to that would be they simply didn't go far enough. The defective price occurred because of a misstatement of material prices on two items, boresight fixtures.

The contractor, General Dynamics, had cited a purchase order for the purchase of a case which was a unique purchase order.

Mr. **Wyden**. Were these costs actually incurred?

Mr. **Quicksall**. I beg your pardon, sir?

Mr. **Wyden**. Were these costs actually incurred?

Mr. **Quicksall**. The costs that—yes, sir. General Dynamics issued a purchase order for one case and paid $1,800 for it. However, they frequently buy that same case for $600. In pricing this action, they priced the case at $1,800.

Mr. **Wyden**. Do you believe, then, that the Westinghouse engineer actually spent 63 hours designing the 3-inch piece of wire?

Mr. **Quicksall**. Sir, I cannot speculate on how much time was spent designing the piece of wire. Somebody charged time to design it—seven engineers.

Mr. **Wyden**. Let me proceed here.

Did you find evidence that there was 21 to 42 percent misbilling for support equipment at General Dynamics?

Mr. **Quicksall**. Yes, sir. There is a joint report, Air Force and DCAA report, issued in I believe 1984, that found that misbillings on support equipment were as high as 42 percent for labor.

Mr. **Wyden**. What did the Air Force do with respect to its misbillings?

Mr. **Quicksall**. General Dynamics is trying to improve its accounting system. However, when we were doing this review this year, in March and April 1985, we found similar misbillings on the two items we examined; that is, labor charges were charged after an item had been shipped, and material incorrectly charged to items.

Mr. Wyden. Mr. Conahan, one last question. On page 9 of the GAO report, you state that 359 engineering hours were recorded by General Dynamics for work related to the Westinghouse items. General Dynamics later transferred the costs for this work to an unallowable account.

Did you, in fact, catch the General Dynamics Corporation defrauding the Air Force?

Mr. Conahan. We noted that the hours had been booked by the General Dynamics Corporation. During negotiations, General Dynamics said they had not included engineering hours in the contract. However, prior to that time these hours had been booked, and we found that they had not been removed from the books. And when we brought it to their attention, they did in fact remove it from the books at that time.

Now, it seems to me that if General Dynamics was acting in good faith in terms of fulfilling its contractual obligations to the Air Force, it would have taken whatever action was necessary on its own at the time to have removed those engineering hours from their books and records. They did not do it.

Mr. Wyden. My time has expired, Mr. Conahan. I appreciate that last point in particular, because I think perhaps you could have a debate with respect to the issue of fraud specifically; and I know that your investigation was not directed just at that, but it seems clear to me that the General Dynamics Corporation intentionally misled the Air Force in this particular case. I think that is an extremely reprehensible action to take.

Do you have any further comment? Would you agree that they intentionally misled the Air Force?

Mr. Conahan. I think that one needs to have further investigation on that particular matter. We were unable to get expressions from the individuals involved, and without expressions from them I don't think that we can make a conclusion.

I think what I can say, and would say, is that throughout this entire relationship on this contract there clearly was a tendency on the part of the contractors to maximize profit, rather than to be concerned with the American taxpayer.

Mr. Wyden. Mr. Chairman, my time has expired but I think certainly this last set of questions demonstrates that the contractors are controlling the system; they are telling the Air Force what is to be used, how to buy it, what price ought to be paid. The Air Force, in effect, in this case, just turned on the money faucet.

I appreciate the opportunity for questions, Mr. Chairman.

Mr. Dingell. The Chair thanks the gentleman.

The Chair recognizes now the gentleman from Minnesota.

Mr. Sikorski. I thank the chairman.

Following up on the gentleman from Oregon's point, it is important for people to appreciate that this isn't an instance where General Dynamics or Westinghouse is out to sell the Government a product that they want to sell to the Government; indeed, the Government, the taxpayers have already paid General Dynamics, pursuant to its contracts associated with the F-16, to recommend a system whereby the Air Force can repair and maintain these radars themselves.

Isn't that correct?

Mr. **Quicksall**. Yes, sir. The General Dynamics contract has a requirement that General Dynamics do those sorts of things, and that requirement has been in the contract since 1977 and is funded at a rate of about $10 million a year.

Mr. **Sikorski**. So, we have an instance where we are talking about a $55 billion F-16 program, aren't we, in terms of the taxpayers?

Mr. **Quicksall**. Yes, sir. I think the report has that in it.

Mr. **Sikorski**. And we are talking about $10 billion through the Air Force; is that a good ballpark figure?

Mr. **Quicksall**. I am sorry, I don't understand the question.

Mr. **Sikorski**. Well, we have about $10 billion specifically contracted through the Air Force of this $55 billion taxpayer expenditure for the F-16?

Mr. **Quicksall**. I am not familiar with the exact numbers, but that would certainly be a fair approximation.

Mr. **Sikorski**. There have been about 580 so-called modifications in this F-16 contract over the course of its term; isn't that correct?

Mr. **Quicksall**. Yes, sir.

Mr. **Sikorski**. They use one of these modifications, and we are using one of them as an example in this instance, are we not?

Mr. **Quicksall**. That is correct.

Mr. **Sikorski**. It was an unpriced contract for repair and maintenance tools so that the Air Force coming on in late 1984 could do its own repair and maintenance of these radars?

Mr. **Quicksall**. That is correct.

Mr. **Sikorski**. Now, the point has to be reemphasized that—and you point out on page 2 of your report—that General Dynamics understands its F-16 contract—the total program is $55 billion—and, I quote, is "specifically obligated to recommend support equipment to maintain the aircraft." And they have been paid about $10 million a year since 1977 to do just that.

Mr. **Quicksall**. That is correct, sir.

Mr. **Sikorski**. Then, pursuant to this contract that they have already been paid about $10 million a year to do, they came up with these recommendations for 24 tools; is that correct?

Mr. **Quicksall**. That is correct, sir.

Mr. **Sikorski**. And further, as I understand that contract, they are required to recommend the most cost-effective way for the design, development and production of these tools; is that correct?

Mr. **Quicksall**. Yes, sir.

Mr. **Sikorski**. So they came up with these 24 tools, some of which duplicate what was already in existence and used for several years at Westinghouse.

Mr. **Quicksall**. Yes, sir.

Mr. **Sikorski**. Some of which are unworkable.

Mr. **Quicksall**. Yes, sir.

Mr. **Sikorski**. And some of which are lost.

Mr. **Quicksall**. Yes, sir.

Mr. **Sikorski**. And some of which have not been used because there are no instructions.

Mr. QUICKSALL. Yes, sir.

Mr. SIKORSKI. But they all cost a lot of money.

On page 7 of your report, you talk about the Air Force Plant Representative Office, the AFPRO I think it is called, raising questions about the reasonableness of the prices of the Westinghouse items and recommending that the items be bought directly from Westinghouse or through local manufacturers.

Is that correct?

Mr. QUICKSALL. Yes, sir.

Mr. SIKORSKI. And that, according to your report, is a sound and good idea.

Mr. QUICKSALL. Yes, sir.

Mr. SIKORSKI. In April 1983, the AFPRO sent a letter to General Dynamics stating that the prices to the Air Force for single-piece items were in the $9,000 to $11,000 category, which from all appearances should have been priced between $2 and $150.

Is that correct?

Mr. QUICKSALL. Yes, sir.

Mr. SIKORSKI. The letter also stated that the assemblies were priced between $13,000 and $28,000, which should have been in the $200 to $500 range.

Is that correct?

Mr. QUICKSALL. Yes, sir.

Mr. SIKORSKI. Altogether, the taxpayers spent over $800,000 for parts of these 24 tools; is that correct?

Mr. QUICKSALL. That is correct, sir.

Mr. SIKORSKI. And according to this AFPRO, none of them should have cost more than $500.

Mr. QUICKSALL. Yes, sir.

Mr. DINGELL. Would the gentleman yield?

Mr. SIKORSKI. Certainly.

Mr. DINGELL. That was, however, after the exposure in the Senate. And it can be observed that the original billing in the Senate was for $1.7 million.

Isn't that correct?

Mr. QUICKSALL. Yes, sir. The unpriced order that you asked us to look at was originally—had a not-to-exceed price on it of about $1.7 million.

Mr. DINGELL. After they got themselves in problems with the Senate, it fell to $900,000.

Mr. QUICKSALL. That is about right, sir.

Mr. DINGELL. All right. And that figure was still a little on the high side.

Mr. QUICKSALL. Yes, sir.

Mr. DINGELL. By probably many orders of magnitude.

Mr. QUICKSALL. Yes, sir.

Mr. DINGELL. Thank you.

I thank the gentleman for yielding.

Mr. SIKORSKI. I thank the chairman.

My final question is, was General Dynamics aware that the Air Force paid Westinghouse for multiple sets of tools originally developed?

Mr. QUICKSALL. The Air Force should have been aware.

Mr. SIKORSKI. How about General Dynamics?

Mr. **Quicksall**. General Dynamics was aware.

Mr. **Sikorski**. And they have a contractual responsibility to recommend the most cost-effective manner for the purchasing by the Air Force, and they were paid to do just that.

Mr. **Quicksall**. Yes, sir.

Mr. **Sikorski**. So they got paid—the program is about $55 billion; they got paid $10 million a year to recommend the most cost-effective and reasonable way of getting the Air Force into its own maintenance program, and yet they recommended these tools which the Air Force Plant Representative said shouldn't have cost more than $500 a piece on the outside.

Mr. **Quicksall**. That is right.

Mr. **Sikorski**. Some between—or around $2.

Mr. **Quicksall**. That is correct, sir.

Mr. **Sikorski**. How can this thing happen?

Mr. **Quicksall**. I cannot explain it.

Mr. **Sikorski**. OK.

Mr. **Conahan**. Mr. Sikorski, we have spoken a good bit here this morning about the contractors. The Air Force is also required to determine the most cost-effective way of providing these items, and I think that some light has to be shown in that direction; that they did not make the necessary analyses that were required.

Mr. **Sikorski**. We have a two-legged system. One is the contractors and one is the—those people in the Government who are charged with expending the taxpayers' money. In both instances—both legs of this system collapsed.

Mr. **Conahan**. Yes, sir.

Mr. **Sikorski**. I thank the chairman.

That was an excellent report.

Mr. **Conahan**. Thank you, sir.

Mr. **Dingell**. The Chair thanks the gentleman.

The Chair recognizes the gentleman from Texas, Mr. Bryant.

Mr. **Bryant**. Mr. Chairman, it appears that all the questions that there are to ask to lay this whole story out of General Dynamics have now been asked. I do have a couple of others I might ask briefly before letting these witnesses go.

One of them is, with regard to the question of fraud and plain misleading of our own Government, you were a little bit, I thought, less than conclusive about it. Let me ask again, is General Dynamics guilty of defrauding the Government in this circumstance?

Mr. **Conahan**. Well, Mr. Bryant, as you know, that is a litigatable issue, and I think we need to leave it to the courts for conclusion.

Mr. **Bryant**. Let me ask this question: I realize—I don't mind if you don't want to be put totally on the spot; I don't want you to get sued personally. But would you recommend to the U.S. attorney's office that this kind of a case be prosecuted under fraud statutes?

Mr. **Conahan**. I would not recommend that it be prosecuted. I certainly would be happy to share with the Department of Justice all of the information that we have developed.

Mr. **Bryant**. Well, would you not recommend it because you don't believe they should be prosecuted for fraud, or because it is not your job to make a recommendation?

Mr. Conahan. It is not our job really to do that. When we develop information which appears to have criminal activity associated with it, we will make a determination as to how best to get that to the Department of Justice. In this case, we had not, quite frankly, gotten to the point of making any sort of referral to the Department of Justice.

Mr. Bryant. I see.

Let me ask you this question: Was the Air Force aware of this whole set of facts when you began this investigation, in your opinion, either of you?

Mr. Quicksall. They should have been aware of almost all of the facts. We have no evidence that they were aware that the numbers were switched on the Westinghouse parts.

Mr. Bryant. Let me ask you this way; how much of what you have presented to us today was already known by the managers of the Pentagon, but had not been revealed to them, and how much was a surprise? Did they take your report and say, my goodness, I am surprised, or not?

Mr. Quicksall. No, sir.

Laying aside the question of the switched parts numbers, the Air Force was aware of all the facts.

Mr. Bryant. Was the Defense Contracting Auditing Agency aware of it?

Mr. Quicksall. They are now.

Mr. Bryant. No, but were they at the time?

Mr. Quicksall. No, sir.

Mr. Bryant. So, the guys aware of it were the Pentagon managers, but the Auditing Agency was not aware of it, and no other authority either in the executive branch or the legislative branch had been told of this circumstance; is that correct?

Mr. Quicksall. I am not sure I understand your question, sir.

Mr. Bryant. Well, this set of facts, which you indicate did not come as a surprise to the Air Force, with the one exception that you mentioned——

Mr. Quicksall. Yes, sir. Most people knew of these facts.

Mr. Bryant [continuing]. And, as far as you could tell, no one in the executive branch and no one in the legislative branch in authority had been informed of it; is that correct?

Mr. Quicksall. Yes, sir. If I understand the question, yes, sir, that is correct.

Mr. Bryant. OK.

Mr. Dingell. Will the gentleman yield?

Mr. Bryant. Yes.

Mr. Dingell. Did you find any evidence of interchange of information among the several agencies in the Defense Department with respect to what was going on before your inquiry commenced? In other words, was the Defense Department Audit Agency informed of what was going on by the procurement people, or had the Defense Department Audit Agency inquired into these matters and then notified the procurement people?

Had anyone notified either the procurement people or the Defense Department Audit Agency that the tools were already in place at Westinghouse and were being used, or was there any information made available with regard to changes in part numbers or the facts relative to the engineering or the cost undertakings of the two contractors?

Mr. QUICKSALL. The Defense Contract Audit Agency's original involvement in this was when the first proposal was made in 1982. And we have studied very carefully their report at that time. They have had no subsequent involvement in it. That is——

Mr. DINGELL. No subsequent involvement at all?

Mr. QUICKSALL. The DCAA audit staff at General Dynamics. The DCAA audit staff at Westinghouse did do some additional work on the Westinghouse costs.

Mr. DINGELL. What was that?

Mr. QUICKSALL. That was after the fact. When most of the money had been spent, they put together some information for the Air Force.

Mr. DINGELL. What information did they put together, and what was done with the information that was assembled?

Mr. QUICKSALL. That information was put together both by the Air Force plant representative office at Westinghouse and also the DCAA at Westinghouse, and that was assembled into a report and given to the Air Force.

Mr. DINGELL. What happened with that? Did you find out?

Mr. QUICKSALL. That report—at that time, of course, all costs had been incurred, and that report essentially states that.

Mr. DINGELL. So, essentially the report was probably a good one, but it was impossible to use for purposes of collecting any of the charges that might have been either improper or excessive; is that correct?

Mr. QUICKSALL. Yes, sir.

That report simply correctly states the dollars that had been spent.

Mr. DINGELL. That was because of the fact that it is almost impossible to retrieve money under this kind of contract; isn't that right?

Mr. QUICKSALL. That is correct, sir.

Mr. DINGELL. Thank you.

I thank the gentleman for yielding.

Mr. CONAHAN. Mr. Chairman, Mr. Bryant, for purposes of clarification in terms of what the Air Force did know, I think the question was asked: Did the Air Force people know that Westinghouse had tools similar to those that were being proposed to be procured? The answer to that question is yes.

The initial documentation submitted by General Dynamics to the Air Force clearly showed that Westinghouse had tools in use at that time.

Mr. BRYANT. Thank you.

I have no other questions, Mr. Chairman. Thank you.

Mr. DINGELL. Mr. Conahan, if I may, I am just a jack leg carpenter but I do work with my hands occasionally. Perhaps you and Mr. Quicksall could give me some answers.

If I knew somebody was repairing a piece of equipment, is there any reason why I shouldn't talk to that person; and if I wanted to procure a set of the tools, just have a good technician either call them up or get on an airplane, go down and get a set of the tools, watch the work being done for a couple days, and then come back and proceed to do the work that had to be done?

Mr. **Conahan**. I think, clearly, much of this whole case would have been averted had something such as that occurred, yes, sir.

Mr. **Dingell**. Is there a lack of logic in that process anywhere? Is there anything in Government rules for procurement or any regulation or any commonsense requirement, or is there any proprietary information, or is there any question of national security that would have precluded the Air Force from just putting somebody on an airplane, going over to visit with Westinghouse, seeing (a) what they did, (b) what their manuals said, and (c) what tools they used, and then watching the work go on for a couple days, and then coming back with a set of tools and proceeding to do the work that had to be done?

Mr. **Conahan**. Not only, sir, is there not a barrier to that, I believe that the regulation requires that steps such as those that you outlined are indeed taken.

Mr. **Dingell**. But they were not taken.

Mr. **Conahan**. But they were not taken.

Mr. **Dingell**. Would you submit for the record the particular part of the regulation that would so direct the Air Force so that we can make it available to them? I think it would be very helpful.

Mr. **Conahan**. Yes, sir.

[The information follows:]

Part 10 of Air Force Logistics Command (AFLC) Regulation 66-68 on "Functions and Responsibilities of the Technical Services Equipment Specialist During System/Equipment Acquisition" states the following.

10. Support Equipment (SE):

a. The identification and acquisition of SE (both developmental and standard) is one of the most difficult support tasks associated with the system or equipment acquisition process. Identification by contractors of SE requirements early in the design development processes and documenting these requirements to the Air Force for validation is paramount to the SE management program. The Air Force evaluation criteria must be in context with system or equipment design requirements (evaluation by implementing command), training requirements (evaluated by Air Training Command), operational requirements (by using command), and projected maintenance programs (by AFLC).

b. It is an AFLC responsibility to edit SE proposals to identify those that could be satisfied by current inventoried SE or by modifying available SE to satisfy the requirement. Additionally, the use of Air Force depot manufacturing capabilities can be effective in developing SE requirements. Centralized depot level manufacture of simple low cost SE and modifications of hand tools is frequently more cost effective than procurement from a contractor. Designation of an item for depot level manufacture or modification must be based on the following criteria:

(1) Cost effective analysis that verifies the decision.

(2) Availability of material and the necessary manufacturing data.

(3) The process of manufacture or modification is compatible with tools, equipment, or available skills.

(4) Quantities required do not impose an undue workload.

(5) SE will be available by need date.

c. The MMT (technical services branch) equipment specialist, as the AFLC focal point for evaluating contractor SE proposals, is responsible for:

(1) Evaluating the comments and recommendations from the other D/MM (directorate of material management) offices and the using commands.

(2) Assimilating this information with his experience and knowledge of system or equipment maintenance requirements.

(3) Based on his findings, performing the following:

(a) Selecting the standard SE required to support the system.

(b) Identifying the adequacy and need of developmental SE proposed by a contractor.

(c) Selecting the developmental SE for depot level requirements.

(d) Advising implementing command of additional SE requirements.

Mr. **Dingell**. Mr. Conahan, you and Mr. Quicksall have been of immense assistance to the subcommittee.

Can you tell us how a thing of this sort could have happened? How could an event of the kind, or series of events of the kind we have been discussing here, have transpired?

Mr. **Conahan**. I think, Mr. Chairman, that we need to look perhaps beyond the instant case. In our observation of procurement in the Pentagon over the past several years, it seems that the reward system in place goes to those people who are successful in fielding weapons systems, and all support systems over there are in support of that sort of a philosophy.

A person who gets this system fielded, or the group of people who get their systems fielded, seem to enjoy a rather good series of rewards. You don't see that happening where people get programs killed or stopped.

Mr. **Dingell**. How about people who save the taxpayers money?

Mr. **Conahan**. Well, I——

Mr. **Dingell**. Let's talk not about the choice between getting the system and getting the system killed; let's talk about a system that is the best price for the taxpayer.

Mr. **Conahan**. I think, sir, in all candor, there is a lot of hard work among all the people in the defense establishment. I do think, however, there is that tendency to do whatever is necessary to get the procurement completed. I think that without——

Mr. **Dingell**. Without regard to cost?

Mr. **Conahan**. Not without regard to cost. I think people think about cost.

Mr. **Dingell**. Which way? The more they spend, the faster they go up; or the less they spend, the faster they go up?

Mr. **Conahan**. I think there is a cost consciousness. The magnitude of the problem over there, the fact that things move rather quickly, and that the emphasis—again repeating myself—is on getting the procurement done rather than on scrubbing it to the point where we could get greater efficiency and economy, moves the entire establishment.

Mr. **Sikorski**. Will the chairman yield?

Mr. **Dingell**. Yes, I would be delighted to yield.

Mr. **Sikorski**. Mr. Conahan, who produces the radar for this Sergeant York gun—DIVAD, that was just canceled—but in the field, very quickly?

Mr. **Quicksall**. Sir, I don't have that information with me right now, but I believe that is a Westinghouse radar.

Mr. **Sikorski**. Thank you.

Mr. **Dingell**. Mr. Conahan and Mr. Quicksall, the subcommittee wants to express our particular accommodations and thanks for the work that has been done. There are certain small matters that remain to be tidied up, like interviewing some of the good folk at Westinghouse that have not been available to you. I am sure after we finish our inquiries today we will find a greater level of cooperation so that the matter can be more fully completed to the satisfaction of GAO, and I think for the benefit of a better record.

With that, the subcommittee expresses our thanks to you and appreciation for an outstanding job well done, both testifying today and also in preparing your report.

The subcommittee would ask, Mr. Quicksall, this is somewhat of an imposition on you, but would you be able to remain in the room just to sort of listen to the testimony so that we could perhaps call upon you if additional information is required?

Mr. QUICKSALL. Yes, sir.

Mr. DINGELL. Please.

Mr. Conahan and Mr. Quicksall are excused from the witness table, with the thanks and appreciation of the subcommittee. Thank you.

Mr. CONAHAN. Thank you, sir.

Mr. QUICKSALL. Thank you.

Mr. DINGELL. The Chair announces that our next witnesses will be a panel composed of the following: Frederick S. Wood, corporate vice president for contracts and pricing, General Dynamics Corp.; Mr. Robert D. Smith, project engineer, Fort Worth division, General Dynamics; Mr. Harry B. Smith, president, Westinghouse Defense and Electronics Systems Center; Mr. Mark Shull, F-16 manager, Integrated Logistics Support Division, Westinghouse Defense and Electronics; Mr. Wilbert C. Cook, director, contracts management, Integrated Logistics Support Division, Westinghouse Defense and Electronics.

We will also be hearing from the Air Force, Maj. Gen. George L. Monahan, Director of Development and Production, Deputy Chief of Staff, Research, Development and Acquisition, the Pentagon; and Brig. Gen. Ronald W. Yates, Deputy for F-16, Aeronautical Systems Division, Air Force Systems Command, Wright Patterson Air Force Base.

The subcommittee thanks you all, gentlemen, for being here with us. If you would each come forward and take your place at the witness table, we will proceed toward having each of you testify.

As you gentlemen may know, since the time of Sam Rayburn all testimony is received under oath. Do any of you object to testifying under oath? If not, then the chairman will inform you that it is your right to have counsel present for purposes of advising you with regard to your rights and also the limitations on the power of this committee.

Do any of you desire to be represented by counsel?

The record will indicate that you do not.

Gentlemen, for the assistance of each of you, you will note that copies of the rules of the committee are there at the witness table, and also copies of the rules of the House. Those will inform you both as to the limitations on the power of the committee and your rights before us.

Since you do not object to being sworn, would you raise your right hand.

[Witnesses sworn.]

Mr. DINGELL. Gentlemen, if you will each take your seat, you may consider yourselves under oath. The Chair advises that it would be helpful, I believe to our reporter, if starting on your left you each identify yourselves for purposes of the record.

General YATES. Brig. Gen. Ronald Yates, F-16 Program Director, U.S. Air Force.

General MONAHAN. I am Maj. Gen. George Monahan, Director of Development and Production, Headquarters, U.S. Air Force.

Mr. COOK. Wilbert Cook, director of contracts management, Integrated Logistics Support Division.

Mr. SHULL. Mark Shull, F-16 manager, Integrated Logistics Support Division.

Mr. HARRY SMITH. Harry Smith, president of Westinghouse Defense and Electronics Systems Center.

Mr. ROBERT SMITH. I am Robert Smith, project engineer at the Fort Worth division.

Mr. WOOD. I am Federick Wood, corporate vice president for contracts and pricing.

Mr. DINGELL. Mr. Wood, Mr. Smith, and Mr. Smith of Westinghouse, and perhaps your associates, do you have opening statements?

Gentlemen, the subcommittee will recognize you or any of you in any order you desire for such opening statements as you deem appropriate.

Mr. WOOD. I will start.

Mr. HARRY SMITH. We are all volunteering.

Mr. DINGELL. You are recognized.

TESTIMONY OF FREDERICK S. WOOD, CORPORATE VICE PRESIDENT, CONTRACTS AND PRICING, GENERAL DYNAMICS CORP., ACCOMPANIED BY ROBERT D. SMITH, PROJECT ENGINEER, FORT WORTH DIVISION; MAJ. GEN. GEORGE L. MONAHAN, JR., DIRECTOR, DEVELOPMENT AND PRODUCTION, U.S. AIR FORCE, ACCOMPANIED BY BRIG. GEN. RONALD W. YATES, DEPUTY FOR F-16, AERONAUTICAL SYSTEMS DIVISION; HARRY B. SMITH, PRESIDENT, DEFENSE AND ELECTRONICS SYSTEMS CENTER, WESTINGHOUSE ELECTRIC CORP., ACCOMPANIED BY MARK SHULL, F-16 MANAGER, INTEGRATED LOGISTICS SUPPORT DIVISION, AND WILBERT C. COOK, DIRECTOR CONTRACTS MANAGEMENT

Mr. WOOD. As all of you know, I am here today at your request for the purpose of providing you to the extent possible with information and data to raise the confidence level of the people in the aerospace industry and we in this business are responsible, honest communities, and corporate citizens. The GAO report which forms the basis of today's hearing raises a number of issues, and I am sure that as the day progresses we will explore each of them in detail and hopefully come to grips with constructive suggested changes to the acquisition process. However, prior to getting into the specific issues I would like to take this opportunity to share with you a few facts.

If you look at the support equipment which was displayed here this morning and which we will talk about today, it is difficult if not impossible to conclude that they have a so-called intrinsic value that equates to the prices that the industry must charge and that the U.S. Government and taxpayers must pay.

Clearly that is evidenced by the display of the items this morning.

The costs of these support equipment items have been analyzed, reviewed, and approved by competent, professional Government employees charged with audit and negotiation responsibility, so we are not talking about whether or not the price is reasonable when evaluated against the defense acquisition regulation criteria; we are talking about the perception or the so-called intrinsic value. It is in that context that I would like to share with you the events which in my judgment contribute most to the actual cost of these support items.

As best I can recall, in the early or mid-1960's, the then Secretary of Defense caused revised process of selection, design, development, and production of support equipment to be implemented with the thought in mind that change was necessary to facilitate identification, development, and delivery to the field of support equipment in time to support the weapons systems as they were fielded.

This new process brought with it the generation of massive amounts of paperwork, contract data requirements list, DD-1423, were generated through every contract which specifically identified and required the contractor to submit an exhaustive array of data.

One of those data requirements was the generation of support equipment recommendation data which has been commonly referred to here as SERD. To give you some insight into what that means, I am attaching and will submit for the record a flow diagram which gives you a detailed pictorial view of the many, many steps, all cost-bearing or cost-generating, that the industry must go through before ever bending metal for a vendor-supplied piece of equipment.

Mr. Dingell. The document referred to will be reviewed by staff for appropriateness in insertion into the record of the proceeding.

Mr. Wood. Thank you, Mr. Chairman.

I would like, however, to display and maybe you would like to have it there for your colleagues, an array of the many, many steps that one must go through in the generation of the paperwork. If you would, please, kind of think in terms of those being people because the bulk of the dollars spent for the items that were displayed this morning clearly, clearly are not in the hardware, they are in all of these steps we are contractually required to go through prior to bending any metal.

I am not here to make a value judgment as to whether or not these events are necessary. The events that I just displayed for you. But what I am suggesting is that these events are necessary to fulfill our contractual requirements. Whether the item is relatively simple or very complex, most of these events occur, thus generating costs.

In mid-1983, General Dynamics heard Senator Roth and the Department of Defense when they spoke out against spare parts in support pricing equipment problems. We took their recommendations seriously and made constructive changes in our in-house policies and procedures.

Mr. Chairman, if you have available a Vu-Graph, I do have one Vu-Graph I would like to display if possible, sir.

Mr. Dingell. I think that would be appropriate.

Do we have a machine of that type? In any event, we will insert the document you refer to into the record, and we will try and get the machine.

We will get you one of those machines. In the meantime you are continued to be recognized. As soon as we get it we will return to this point.

Mr. Wood. What I will display when the machine arrives is the fact we have done some things internally over the last 18 months to try to improve our process. Clearly like everyone else in the business, including you gentlemen, we are all working diligently to try to make the corrections that are necessary.

It is not easy, it is a very complicated and difficult process. We will continue to work with it and if there is anything constructive that comes out of this hearing or any other hearings, we certainly will do everything possible to try to implement them.

Thank you very much, Mr. Chairman. I will be prepared to answer any questions that I possibly can that pertain to General Dynamics to the best of my ability to do so.

[The charts referred to follow:]

Actions to Improve Spares/Support Equipment Acquisition Process

Action	Primary Application		Objective
	Spares	Support Equipment	
1. Simplify Support Equipment Design & Increase Opportunities to Reduce Cost		√	Reduce Cost
2. Buy in Larger Quantities	√	√	
3. Breakout Items for Competition	√	√	
4. Buy Directly from Manufacturer	√	√	
5. Prorate Administrative and Support Costs By Dollar Value	√	√	Achieve Unit Cost Integrity
6. Separate Nonrecurring and Recurring Cost		√	
7. Individual Item Cost Estimate Review	√	√	

Simplify Support Equipment Design and Increase Opportunities to Reduce Cost

- Use Existing Designs/Equipment to the Maximum Extent Practical
- Review Designs with Manufacturing, Procurement, and Logistics Departments and Incorporate Cost Reduction Suggestions
- Specify GFE/Air Force Local Manufacture for Simple Tools and Equipment Where Practical
- Recommend GFE Where Practical
- Provide Opportunity for Competitive Procurement of Contractor Furnished Items
    - For Non-Complex CFE Items, Stress "Buy" As Opposed to In-House Make
    - Increased Emphasis on Use of Specification Control Drawing to Improve Capability for Competitive Procurement

Buy in Larger Quantities

- Economic Order Quantities
  - — Economic Order Quantities Identified in Initial Recommendation to Government
  - — Agreement Reached with Local ACO to Approve Order Quantities to Accommodate Minimum Buys
- Spares Multiyear Procurement Initiative with Ogden ALC
  - — Take Advantage of MYP II Production Release (1 Nov 84 - 1 Feb 85)
  - — Firm Proposal for 79 Subcontractor Items (Varying Quantities)
  - — Firm Proposal for 106 GD Manufactured Items (Varying Quantities)
- Support Equipment Multiyear Procurement Initiative with F-16 SPO
  - — Preparing Four Year Support Equipment Procurement to Parallel MYP II
  - — Eighty-Eight (88) Separate Support Equipment Items in Varying Quantities for a Total of 4,848 Units

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Breakout Items for Competition/Direct Buy

- **Supplied a Listing of Non General Dynamics Manufactured F-16/F-111 Items to Each Air Logistics Center in July 1984**

	Spares Part Nos.	*Support Equipment Part Nos.*
Ogden ALC	**8,060**	**128**
San Antonio ALC	**2,596**	**1,195**
Warner Robbins ALC	**1,100**	**975**
Oklahoma City ALC	**1,045**	**37**
Sacramento ALC	**522**	**64**
TOTAL	**13,373**	**2,399**

- **Example of Data Provided**

Manufacturer's Part Number	*Federal Supply Code for Manufacturers*	*Nomenclature*	*Stock Number*	*SMR Code*
29109	**07148 (Dynamic Controls Corp.)**	**Power Board Assembly**	**14300010833438BJ**	**PAODDT**

- **Competition Advocate and Item Managers at Each ALC Reviewing Lists for Appropriate Breakout and Competition Actions**

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Buy Directly from Manufacturer

- **Replenishment Spares and Support Equipment**
  - **All Government Requests for Quotes Received for Non General Dynamics Manufactured Items Are and Will Continue To Be "No Bid"**
- **Provisioned Spares and Support Equipment**
  - **Identify Manufacturer in Data Submittals**
  - **Process Orders for Non General Dynamics Manufactured Items After Written Government Recognition of GD Procurement Action**
- **First Unit Support Equipment (Where Development Is Involved)**
  - **Will Propose Task for Both Make and Buy Items**
  - **Breakout Subsequent Procurement of Non General Dynamics Manufactured Items for Direct Government Buy**

Prorate Administrative and Support Costs By Dollar Value

- In the Past, Administrative and Other Support Costs Were Equally Prorated to Each Item
  - This Distorts Unit Cost, Especially for Low Dollar Items
- Support Equipment Estimating/Accounting Techniques Revised in June 1984 to Prorate Administrative and Other Support Costs By Dollar Value of Item
- Spares Estimating/Accounting Techniques Being Revised to Fully Prorate Administrative and Other Support Costs By Dollar Value of Item–
- Examples of New Support Equipment Estimating Approach

	Before New Estimating Approach	*After New Estimating Approach*
Transparency Release Ram	$ 2,708	$ 761
Adapter Wrench	$ 565	$ 101
Antenna Inspection Part Reference	$ 1,020	$ 635
Servo Actuator Rigging Tool Kit	$ 1,185	$ 221
Stores Management System Test Set	$128,002	$142,216

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A59117

Separate Nonrecurring and Recurring Cost

- **Current Air Force Support Equipment Procurement Practices Require All Nonrecurring Costs for Unit #1 To Be Included in Hardware Costs**
    - **— Results in Serious Unit Cost Distortion for Initial Unit**
- **General Dynamics Has Revised Internal Estimating and Accounting Procedures to Separately Identify Recurring and Nonrecurring Costs**
- **General Dynamics Discussing Different Support Equipment Contracting Approaches with Air Force**
    - **— Revisions in Air Force Contracting Approaches Needed to Allow Separate Contract Vehicle or Contract Line Item for Nonrecurring Cost**
- **This Nonrecurring Cost Problem Surfaces Primarily in Support Equipment Procurement. However, Occasionally it Surfaces in Spares Procurements, Especially with Low Quantity Orders for Out of Production Parts**

A59118

Individual Item Cost Estimate Review

- **Dedicated Spares Estimating Group**
- **Separate Procurement Group to Analyze Supplier/Vendor Proposals**
- **Price Comparisons with Historical Data and Prior Orders**
- **Assessment of Proposed Price with Intrinsic Value**

- **Examples of Results**

	Initial Estimate	*Final Proposal*
Data Transfer Unit	$ 93,108	$ 23,132
Machine Screw	130	0.22
Toggle Switch	69	4.14
Bracket	122	63
Lanyard	419	266
Pilot Control Cover	147	56
Fixture Assembly	$ 233,613	$ 175,339

Mr. **Dingell**. Thank you, Mr. Wood.

Mr. Smith, I guess you are next.

TESTIMONY OF HARRY B. SMITH

Mr. **Harry Smith**. Thank you, Mr. Chairman.

I welcome the chance to be here today and particularly after the remarks of the members of the committee to try to shed light on this very pertinent subject.

I will not read my summary, but enter it into the record with your permission.

Mr. **Dingell**. Without objection, that will be inserted in full in the record, and we will recognize you for such statements as you feel appropriate.

Mr. **Harry Smith**. I would like to highlight the points in the summary that go to the heart of the issue.

I might say incidentally, I have an engineering background, I have been in my present job since 1977.

I think I would go right to the heart of the matter, the GAO report. I must say that I found the GAO report quite accurate in the assessment of costs, and I thought when in your notice they examined over 50 percent which I think is a pretty good sample of the costs and labor and material, and I think we have no quarrel with their conclusions in the cost area.

However, I say in my opening statement I feel even more strongly after hearing the testimony just given, that a fundamental point has been missed in the procurement of support equipment and the process it must go through as Mr. Wood has just alluded to.

It is really that process which drives the cost of things, even as simple as an alignment, can. So I would like to focus on the two questions raised by the GAO, why did the Government incur the cost of purchasing Westinghouse support equipment when it was already paid for in an earlier contract under shop tooling?

The second point really is a related point to the first, and it says, were these apparently simple, non-complexity of certain items of support equipment, are the costs reported by Westinghouse consistent with the realistic assessment of the design requirement?

Now, to kind of dramatize what I am talking about, if we had turned over the tools directly to the Air Force with the possible exception of those that had substantial material costs like this vacuum and heat test stand, the costs that we would have incurred that the Government would have had to pay, no matter who did it, would have been substantially the same. Which is another way of saying that whether that was a piece of wire, a lollypop stick or a little more sophisticated pin, the cost of the process would have resulted in the total cost to the Government of approximately the same amount.

Now, that would have been true if we did this, if General Dynamics did it, or if the Air Force had done it. I think we can substantiate that statement with a better understanding of the process. So it is not the intrinsic value of the things, but the process that has cost money.

Let me express my regret that the way we conducted what I thought was a very systematic GAO interface was misinterpreted as our trying to prevent the GAO from talking to our engineers. Believe me, I was quite anxious that they get the facts as accurately as possible, because I thought the facts go a long way in supporting the validity of what we do.

So I would like to just trace what really started it all with the actual documents. With your indulgence, I will just submit to the record this one guaranty document that goes back to June 1981, and this whole thing came about because we ran a very successful validation test showing that this antenna could be disassembled and reassembled. That was required by our contract.

But it says, during validation of to and so forth, April 1981, it was noticed that Westinghouse Electric Corp. performed selected disassembly and assembly procedures using the special tools listed in the attachment A. They turn out to be the items that this committee is discussing.

Upon further investigation, it was discovered that Westinghouse Electric Corp. had never submitted SERD, which stands for support equipment recommendation data. I emphasize "recommendation data."

And to illustrate what that really means—and we will be talking a lot about SERD, all of us—I have here, as part of the record I am submitting, the 11 SERD's that constitute the items you are all interested in.

We might observe that these are rather simple documents. They are 2 pages, and the cost is very modest, the administrative cost of preparing these documents. They have the little sketch. This is the genesis of the support equipment recommended data.

We must be careful with the semantics because a SERD is not the whole process. The SERD is this document, but where we spend the money is in the process that this triggers to procure the item of support equipment.

You notice that if you looked at the one on the alignment pin, it has just got a straight line on a piece of paper, so it is a very simple drawing.

The thing I would really like to point out, and this question has been raised, every one of these 11 have a statement on part 2. Part 1 tells you what it is for. Part 2 is called recommended solution. Every item says this item is in use at Westinghouse for this purpose.

This item, our records indicate, was picked up by General Dynamics, who virtually repeated this and submitted it to the Air Force with that statement: "This item is in use at Westinghouse for this purpose."

I don't think there is any question on whether or not General Dynamics and the Air Force was aware of all this information.

Now, I guess a final—incidentally, there is one other thing you should know, I believe. In connection with this original letter that I just read that said you have to submit SERD's, it gave us one other alternative which I think goes to another question you asked.

If you don't submit SERD's, you must look in the Air Force inventory to see if there are any parts that could be used in lieu of submitting SERD's. That is a very easy process to follow, because one of the reasons for having SERD numbers is so you can keep track of everything in the Air Force inventory through this Federal part number system. So you can find it by looking in one document whether or not anything like this exists in the inventory.

So, with that in mind, I think the GAO asked the question about the process.

I think at this point General Dynamics had three options: They could disapprove the recommendation of these 11 SERD's; they could provide the item themselves; or they could procure the item from Westinghouse with or without changes.

Now, when I say they could provide the item themselves, I guess they could go anywhere else and find the item.

As you know, General Dynamics elected to procure the support equipment from us and that triggered the work which was audited by the GAO and which accounts for all the money, including the 63 hours.

There was no development work and perhaps we used the term, nomenclature, "design engineering," but that is plain engineering and most of it is in verification.

Let me just indicate—this is contained in my statement—the items that we actually have to go through. We have no options, once we go ahead with the SERD, we don't have any discretion as to whether or not we do these.

I will just give you a quick summary. Once we turn on the work, get this authorization to proceed, there are about 10 items of management that we have to go through before we are going to collect the costs.

I think what you are most interested in is the 25 items of engineering and it is in this exhibit. I won't take the time to read them all but it is a very comprehensive list.

So when you are talking about 63 hours, you really have to divide it by about 25 different steps, which would average less than 3 hours a step. You must remember this process is set up whether it is a simple pin or a very complicated piece of test equipment.

Manufacturing responsibility has 11 items; quality control, there are 10. Then you finally get down to the last three, which is perform acceptance test, perform compatibility test, and certify performance through recorded data.

At that point, this tool can be given a legitimate part number and has acquired a pedigree, is the word I like to think about it—perhaps you may not like that word. But what we have done is take a tool that we could not use in the field, according to all the regulations, and we have done this work to give that tool a pedigree. And at that time we design—we gave it the part number when we wrote the SERD, but we couldn't use that part number until we had gone through all this process.

So that is why we incurred the costs, and, as I say, we will be happy to go over any of these costs that you would like. And I am at your disposal to answer any further questions.

[Testimony resumes on p. 97.]

[The prepared statement and attachments of Harry B. Smith follows:]

23 September 1985

TESTIMONY OF HARRY B. SMITH

President, Defense and Electronics Center

WESTINGHOUSE ELECTRIC CORPORATION

Before the U.S. House of Representatives Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce

Good Morning Gentlemen:

My name is Harry B. Smith. I am President of the Defense and Electronics Center of the WESTINGHOUSE ELECTRIC CORPORATION and manage the Defense Business Unit of that corporation. Throughout our long history of serving the nation as a defense contractor, we have always abided by the highest standards of business ethics and commitment to the interests of our armed services. Many of our managers have devoted their entire professional careers to meeting the defense needs of the nation and have produced some of the world's most sophisticated radars -- upon which the security of the nation and the lives of our servicemen depend.

I, personally, have been involved in the electronics end of this business since 1952; initially in the technical design phase of the business, and later in engineering management and general management activities. I have been in my present position since 1977.

I have brought with me today, two of my associates, Mark Shull, our Integrated Logistics Support Manager for the F-16 program, and Wilbert Cook, who is our Contracts Management Manager for the Integrated Logistics Support Divisions.

I appreciate the opportunity to submit these opening remarks because I am proud of the record we at the Westinghouse Defense and Electronics Center have made over the years in providing our military equipment at fair costs.

Over the last few months, the GAO has conducted an extremely detailed and meticulous review of the records and activities of Westinghouse in connection with our sale to the Air Force of certain support equipment for the F-16 radar antenna. According to the report, the GAO traced over 50% of the labor and material costs of the support equipment, and countless hours were spent by GAO and Westinghouse personnel tracking down the answers to every question raised by the GAO with respect to the costs, contracts, design, manufacturing, and many other facets of this order. At the conclusion of this extremely rigorous review, the GAO concluded that -- and I quote -- "...the charges were accurately recorded and they supported Westinghouse cost records...". The report further indicates that the GAO was asked "...to determine responsibility for the acquisition of these support equipment items and their resulting cost to the Air Force." Neither in that section, nor in any other part of the record did the GAO indicate that there were or might be any improper or illegal actions on the part of Westinghouse in connection with this acquisition.

The two most significant questions raised with respect to Westinghouse by the report were:

- Why did the government incur the cost of purchasing Westinghouse support equipment when it had already paid for earlier development of like items, which we refer to as "shop tooling?"

- In view of the apparent non-complexity of certain items of support equipment, are the costs recorded by Westinghouse consistent with a realistic assessment of design requirements?

To those who are experienced in the procedures for procurement of support equipment, these questions suggest that, while the GAO spent extensive time investigating the facts of this particular procurement, it did not spend nearly enough time in getting an understanding and appreciation of the support equipment procurement process which DOD regulations require all of us to follow. Had the GAO explored further, it would have discovered that, even if Westinghouse could have supplied the Air Force with the exact items that were earlier developed for use at Westinghouse, the comprehensive work required to meet these DOD regulations would have resulted in essentially the same costs to the government. For many of the items supplied by Westinghouse, neither the apparent non-complexity nor the development of the items were a significant factor in determining the costs.

I cannot stress enough that an understanding of this government required process is extremely important to an appreciation of this purchase order. This process has its roots in procedures established years ago under Secretary McNamara. In order to provide you with a better understanding of the support equipment procurement process, I would like to give you a brief explanation.

Under strict government imposed regulations we are required to initiate the support equipment process by informing the government of support equipment required for the maintenance of their system. We do this in accordance with the SERD process. SERD stands for Support Equipment Recommendation Data. The submittal of data is in two parts: the first, outlining the requirement for an item of support equipment; and the second, outlining the proposed solutions. As an example, I have copies of eleven SERDs for the AN/APG-66 antenna and have attached copies of these to my opening remarks. In these documents, the maintenance problem is discussed, and the solution, including a conceptual sketch of the proposed support equipment is supplied. I would like to note that in these documents we informed General Dynamics that shop tools were in existence and in use at Westinghouse. Our records indicate that General Dynamics passed this information to the Air Force. After receipt of these documents, General Dynamics had several options. These are:

1. Disapprove the recommendation
2. Provide the item itself
3. Procure the item from Westinghouse (with or without change)

In this case, General Dynamics elected to procure the support equipment from Westinghouse. Based on this election, we were required to price and furnish this support equipment, including all contractually required documentation. Note, however, that the contractor cannot supply his own shop tooling, since it is not a contractually deliverable item and will not meet the rigid Air Force specifications. This shop tooling could only be used as a model for developing support equipment that conforms to the requirements placed on us by our contract that incorporate government regulations.

Based on receipt of a modification of our contract for support equipment, we must then manufacture, test and deliver support equipment, including documentation per our contract requirements. Included in these requirements is the need for the contractor to perform the following:

Authorization To Start Work

1. Issue General Orders
2. Establish Funding Limits
3. Issue Contract Performance Schedules
4. Issue Security Requirements (DD-254 Information)
5. Issue Quality Requirements
6. Issue Shipping Instructions

Support Equipment Program Management

1. Allocate Funding Limits to Engineering, Manufacturing, Test and Quality Departments
2. Prepare and Issue Detail Contract Performance Schedules
3. Monitor Contract Performance to Contract Schedules
4. Coordinate Contractual Data Requirements
5. Submit Contractual Data to Customer
6. Coordinate Shipping of Support Equipment
7. Monitor Financial Performance
8. Prepare Cost-To-Complete Estimates
9. Provide Status Visibility To Program Office
10. Coordinate the Scheduling of Design Reviews and Demonstrations

Engineering Department Responsibilities

1. Review Contract Specification Requirements
2. Review Support Equipment Requirement Against End Items
3. Interface With Radar Design Engineers and Review Existing Shop Tooling
4. Acquire Necessary Radar Drawings
5. Design Support Equipment (Hand Drawings)
6. Review Drawings for Use of Material Standards
7. Issue Drafting Request (DR)
8. Prepare Required Drawings and Parts Lists
9. Maintain Drawing Configuration Control Records
10. Issue Advance Order Authorization (AOA) for Material Procurement
11. Follow Drafting Progress and Review Drawings
12. Approve Drawings
13. Issue Engineering Authorization to Manufacture (EAM)
14. Prepare Documentation Package for Design Review(s) With Customer
15. Lead Design Review(s)
16. Attend Status Meetings With Engineering Administration
17. Write Acceptance Test Procedure for Support Equipment
18. Write Compatibility Test Procedure for Support Equipment
19. Follow Manufacturing Progress
20. Prepare and Issue Revision Notices as Required
21. Approve Incorporation of Drawing Change(s)
22. Assist Test Department in Acceptance Testing
23. Assist Test Department in Compatibility Testing
24. Assist Test Department in Acceptance Testing Demonstration to Customer
25. Assist Test Department in Compatibility Testing Demonstration to Customer

Manufacturing Responsibilities

1. Issue Purchasing Requisitions for Material Procurement
2. Prepare Manufacturing Information and Shop Routings
3. Monitor Material Receipts
4. Release Material and Manufacturing Information to Shop
5. Coordinate Shop Progress
6. Attend Status Meetings With Engineering Administration
7. Manufacture Support Equipment
8. Submit Support Equipment for Quality Inspections
9. Transport Support Equipment to Packing and Shipping Department
10. Prepare Shipping Document (DD-250)
11. Pack and Ship the Support Equipment

Quality Control Responsibilities

1. Issue Quality Assurance Program Directive
2. Review and Sign All Purchase Requsitions
3. Interface and Attend With Customer All Required Final Inspections and Demonstrations

4. Perform In-Process Inspections as Required by AFPRO
5. Review Correctness of Shipping Documents (DD-250)
6. Act as Focal Point for Workmanship, Design or Documentation Deficiencies Between AFPRO and Appropriate Westinghouse Department
7. Inspect Final Packaging Before Shipment
8. Certify Vendors
9. Perform Incoming Inspection
10. Perform Source Inspections of Vendors

Test Department Responsibilities

1. Perform Acceptance Test
2. Perform Compatibility Test
3. Certify Performance Through Recorded Data

This is obviously an extensive list of work that must be done on each and every item of support equipment that is procured by the Air Force. It is not work done capriciously at the whim of Westinghouse, but work done because it is absolutely required by Government regulations and imposed on Westinghouse through the contract. It is our understanding, Westinghouse has no authority to deviate from this process, and that no item of support equipment can enter the Air Force inventory without going through the entire mandated process. The most important distinction between a shop tool and an item of support equipment is that the item of support equipment comes with a pedigree -- a pedigree supplied by compliance with the process I have described above. The requirements of that process are not imposed upon or in any way applicable to shop tooling. Further, the importance of this pedigree should not be underestimated. It provides the Air Force with availability, reproducibillity, configuration control, reliability, maintainability, and standardization. Compliance with the support equipment procedures and regulations does not imply any degree of wrongdoing on the part of government contractors or their customers.

Recent reports in the press have raised questions of impropriety on the part of Westinghouse, and I trust the Committee will agree that -- based on the facts I have presented here -- our corporation has acted ethically and legally in these contracts.

LAY IN — HARRY SMITH

GENERAL DYNAMICS
Fort Worth Division

P. O. Box 748, Fort Worth, Texas 76101
(817) 732-4811

81-5049

#1

ILSD Action

File 39A5-10

FCR/81-5911
23 June 1981

Beck

Silver
Duffy
File

Westinghouse Electric Corporation
Defense and Space Center
Aerospace and Electronic Systems Division
P.O. Box 746, MS-267
Baltimore, Maryland 21203

Attention: Mr. W.F. Semotan

Subject: Special Tools Required for Depot Overhaul of the Westinghouse Radar Antenna, P/N 681R241G01 (PBN 54-8)

Attachment: (A) Special Tools Required for Depot Overhaul of the Radar Antenna

Gentlemen:

Westinghouse Electric Corporation has a contractual requirement in accordance with PBN 54-8 to deliver validated disassembly and assembly procedures for support of the radar antenna, part number 681R241G01. During validation of T.O. 11F-29-3 on 24-29 April 1981, it was noted that Westinghouse Electric Corporation performed selected disassembly and assembly procedures using the special tools listed in Attachment (A). Upon further investigation it was discovered that Westinghouse Electric Corporation had never submitted SERD's on these special tools to GD/FW as required.

Since the tools listed in Attachment (A) are not currently in the Air Force inventory, we are left with only two (2) alternatives:

1. That Westinghouse Electric Corporation should provide to GD/FW SERD packages on the tools listed in Attachment (A) at no cost to GD/FW or the Government.
2. That GD/FW rescind the validation of T.O. 11F-29-3 and require Westinghouse Electric Corporation to restructure said T.O. using tools currently available in Air Force Inventory.

Your immediate response to this timely issue is greatly appreciated.

Sincerely yours,

J.M. Chaney

J.M. Chaney
Buyer, Dept. 086

file: 1701.2
cc: D. Scarborough

AVAILABLE

ATTACHMENT (A)

Special Tools Required for
Depot Overhaul of the Radar Antenna

Part Number	Nomenclature	Use and Application
5K646R501TXC	Pulley Puller	Remove drive pulley from motor shaft
646R498TXA	Clamp Alignment Tool	Installation and removal of motor pulley
646R510TXB	Pulley Puller	Remove motor pulley
682R704TXA	Set Indicator (AZ)	Measure shaft position
682R697TXA	Set Indicator (EL)	Measure shaft position
646R707PTXA	Motor Puller (AZ)	Pull motor from Arm Assy
646R708PTXA	Motor Puller (EL)	Pull motor from Arm Assy
(UNKNOWN)	Modified Allen Wrench	Loosen clamp within pulley cavity
643R508TXA	Clamp Alignment Tool	Installation of Motor Pulley
681R282TXB	Non-Metalic Tool	Depress Motor Brushes
SK-682R597TXA	Indicator Tool	Indicate shaft position

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)

LEVEL OF MAINTENANCE DEPOT

CONTRACTOR: WESTINGHOUSE ELECTRIC CORPORATION
CONTRACT NO. F33657-75-C-0310
DOCUMENT NO.. 3426B73G01
CONFIGURATION ITEM: F-16 Fire Control Radar
PAGE NO. : 1
REVISION : Original
DATE . 2 November 1981

PART I – FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplifier RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receiver circuitry. A large portion of of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

Over time the F-16 Antenna Drive pulleys can become friction bound to the motor shafts upon which they are mounted. A special tool is needed to remove without damage friction bound pulleys during antenna repair/overhaul at the depot.

PART II - RECOMMENDED SOLUTION

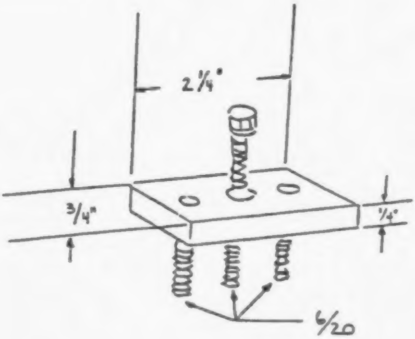
A Pulley Puller Tool, Westinghouse P/N 3426B73G01, is recommended to satisfy the above Part I requirements. This items is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
			CONTR	USAF	
38	F-16 ANTENNA PULLEY PULLER TOOL	ENG			
		PROC			

REF: DI-S-3596A FIG. 1A
Form DF-83

PAGE 1

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)



F-16 ANTENNA PULLEY PULLER TOOL

FIGURE II-1

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)

LEVEL OF MAINTENANCE	DEPOT

CONTRACTOR	WESTINGHOUSE ELECTRIC CORPORATION
CONTRACT NO.	F33657-75-C-0310
DOCUMENT NO.	3426B75G01
CONFIGURATION ITEM	F-16 Fire Control Radar
PAGE NO.	1
REVISION	Original
DATE	2 November 1981

PART I – FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receiver circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

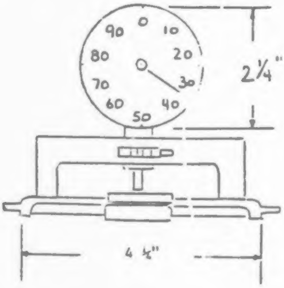
For proper operation and to minimize mechanical wear an azimuth drive motor shaft must be centered and seated precisely when replaced. A special tool is needed to ensure that this shaft is properly positioned when its installation is necessary during F-16 Antenna repair/overhaual at the Depot.

PART II - RECOMMENDED SOLUTION

An Azimuth Shaft Positioner Tool, Westinghouse P/N 3426B75G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
			CONTR	USAF	
40	F-16 ANTENNA AZIMUTH SHAFT POSITIONER TOOL	ENG			
		PROC			

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)



0
10
20
30
40
50
60
70
80
90
2¼"
4 ½"

F-16 ANTENNA AZIMUTH SHAFT POSITIONER TOOL

FIGURE II-1

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)

LEVEL OF MAINTENANCE DEPOT

CONTRACTOR	WESTINGHOUSE ELECTRIC CORPORATION
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO.	3426B76G01
CONFIGURATION ITEM:	F-16 Fire Control Radar
PAGE NO.	1
REVISION :	Original
DATE	2 November 1981

PART I – FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receive circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely efficiently perform several of these disassembly/assembly maintenance actions.

For proper operation and to minimize mechanical wear an elevation drive motor shaft must be centered and seated precisely when replaced. A special tool is needed to ensure that this shaft is properly positioned when its intallation is necessary during F-16 antenna repair/overhaul at the Depot.

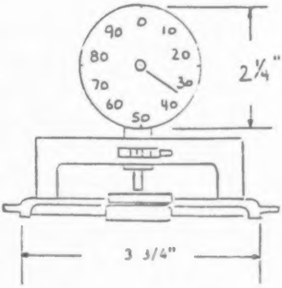
PART II - RECOMMENDED SOLUTION

An Elevation Shaft Positioner Tool, Westinghouse P/N 3426B76G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
			CONTR	USAF	
41	F-16 ANTENNA ELEVATION SHAFT POSITIONER TOOL	ENG			
		PROC			

REF: DI-S-3596A FIG. 1A
Form DF-85

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)


0
10
20
30
40
50
60
70
80
90
2¼"
3 3/4"

F-16 ANTENNA ELEVATION SHAFT POSITIONER TOOL

FIGURE II-1

LEVEL OF MAINTENANCE	DEPOT

CONTRACTOR	Westinghouse Electric Corporation
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO.	3426B77G01
END ITEM	F-16 Fire Control Radar
PAGE NO	1
REVISION NO	Original
DATE	2 November 1981

PART I - FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receive circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

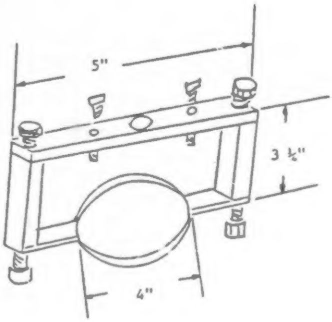
The antenna drive motors are physically located within casting cavities on the associated gimbles. An Azimuth motor puller tool is needed for removal of this motor from its cavity when its repair or replacement is required at Depot.

PART II - RECOMMENDED SOLUTION

An Azimuth Motor Puller Tool, Westinghouse P/N 3426B77G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
			CONTR	USAF	
42	F-16 ANTENNA AZIMUTH MOTOR PULLER TOOL	ENG			
		PROC			

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)



F-16 ANTENNA AZIMUTH MOTOR PULLER TOOL

FIGURE II-1

AEROSPACE GROUND EQUIPMENT RECOMMENDATION DATA (AGERD)

LEVEL OF MAINTENANCE DEPOT

CONTRACTOR	Westinghouse Electric Corporation
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO	3426B78G01
END ITEM	F-16 Control Radar
PAGE NO	1
REVISION NO	Original
DATE	2 November 1981

PART I - FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receive circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

The antenna drive motors are physically located within casting cavities on the associated gimbles. An elevation motor puller tool is needed for removal of this motor from its cavity when its repair or replacement is required at depot.

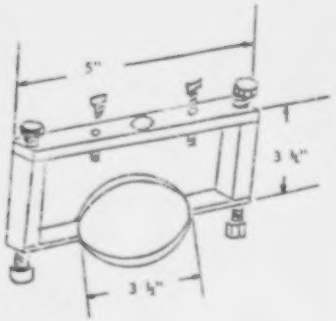
PART II - RECOMMENDED SOLUTION

An Elevation Motor Puller Tool, Westinghouse P/N 3426P78G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II.1

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
			CONTR	USAF	
43	F-16 ANTENNA ELEVATION MOTOR PULLER TOOL	ENG			
		PROC			

REF: DI-S-3396/S-134-2 FIG 1A

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)



F-16 ANTENNA ELEVATION MOTOR PULLER TOOL

FIGURE II-1

AEROSPACE GROUND EQUIPMENT RECOMMENDATION DATA (AGERD)

LEVEL OF MAINTENANCE

CONTRACTOR	Westinghouse Electric Corporation
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO	3426B79G01
END ITEM	F-16 Fire Control Radar
PAGE NO	1
REVISION NO	Original
DATE	2 November 1981

PART I - FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy gnerated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receiver circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

When a drive pulley is installed on a motor shaft during depot repair/overhaul of the F-16 Antenna, its height postion is critical. A special gauge is needed to ensure that when pulleys are mounted on motor shafts that they are positioned at the proper height.

PART II-RECOMMENDED SOLUTION

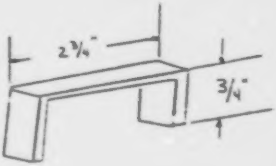
A Pulley Height Gauge, Westinghouse P/N 3426B79G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
44	F-16 ANTENNA PULLEY HEIGHT GAUGE		CONTR	USAF	
		ENG			
		PROC			

REF DI-S-3596/S-124-2 FIG 1A

PAGE 1

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)



F-16 ANTENNA PULLEY HEIGHT GAUGE

FIGURE II-1

REF DI-S-3398A FIG. 1A (Cont.)
Form DF-85

AEROSPACE GROUND EQUIPMENT RECOMMENDATION DATA (AGERD)

LEVEL OF MAINTENANCE

CONTRACTOR	Westinghouse Electric Corporation
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO	3426B82G01
END ITEM	F-16 Fire Control Radar
PAGE NO	I
REVISION NO	Original
DATE	

PART I - FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Frequency (LPRF) unit and accepts return signals for delivery to radar receive circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

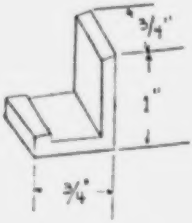
Replacement of F-16 Antenna azimuth and elevation drive tapes will be required at the Depot. A special tool is needed at each tape end (minimum quantity: two), to retain these tapes in place and properly tension them when replacement is necessary.

PART II - RECOMMENDED SOLUTION

A Tape Block Tool, Westinghouse P/N 3426B82G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-I.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
47 (74975)	F-16 Antenna Tape Block Tool		CONTR	USAF	
		ENG			
		PROC			

REF DI-S-3396/S-126 B FIG 1A



F-16 ANTENNA TAPE BLOCK TOOL

FIGURE II-I

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)

LEVEL OF MAINTENANCE DEPOT

CONTRACTOR	WESTINGHOUSE ELECTRIC CORPORATION
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO.	3426B84G01
CONFIGURATION ITEM	F-16 Fire Control Radar
PAGE NO	1
REVISION	Original
DATE	2 November 1981

PART I – FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receive circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

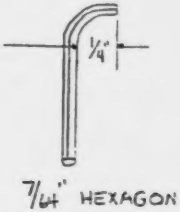
Antenna Motor pulleys are secured to their respective drive shafts with a clamp held in place by a 7/64 Hexagon screw. This clamp is located within a cutout in the pulley. A modified hexagon wrench is needed to access its holding screw because of its constricted location.

PART II - RECOMMENDED SOLUTION

A hexagon wrench, Westinghouse P/N 3426B84G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
49	F-16 Antenna Hexagon Wrench		CONTR	USAF	
		ENG			
		PROC			

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)


1/4"
7/64" HEXAGON

F-16 ANTENNA HEXAGON WRENCH

Figure II-I

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)

LEVEL OF MAINTENANCE

CONTRACTOR	WESTINGHOUSE ELECTRIC CORPORATION
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO	3426B85G01
CONFIGURATION ITEM	F-16 Fire Control Radar
PAGE NO	1
REVISION	Original
DATE	2 November 1981

PART I – FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receive circuitry. A large portion of the antenna is not included in the Five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

Disassembly/Reassembly of Antenna Drive Motors will be required at Depot to effect overhaul or repairs. Two alignment pins are needed to act as guides and assure proper stator positioning when its reinstallation is required during motor reassembly.

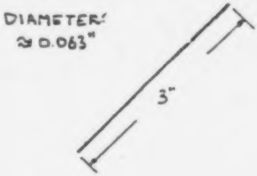
PART II - RECOMMENDED SOLUTION

A steel pin, Westinghouse P/N 3426B85G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
			CONTR	USAF	
50	F-16 Antenna Motor Assembly Alignment Pins	ENG			
		PROC			

REF: DI-S-3596A FIG 1A
Form DF-85

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)


DIAMETER:
≈ 0.063"
3"

ALIGNMENT PIN

FIGURE II-1

SUPPORT EQUIPMENT RECOMMENDATION DATA (SERD)

LEVEL OF MAINTENANCE **DEPOT**

CONTRACTOR	WESTINGHOUSE ELECTRIC CORPORATION
CONTRACT NO	F33657-75-C-0310
DOCUMENT NO	16PR011
CONFIGURATION ITEM	F-16 A/B Fire Control Radar
PAGE NO	1
REVISION	B
DATE	6 May 1983

PART I – FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receiver circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceble Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

Replacement of F-16 Antenna azimuth and elevation drive motor brush assemblies will be required at the Depot. Since the azimuth and elevation motors are of different sizes and since their are two suppliers of the motors there are four (4) different sizes of brush assembly tools needed. Four (4) non-magnetic tools made of a material which will not abrade or damage brushes or rotor are needed to retract the brushes during assembly of the motors.

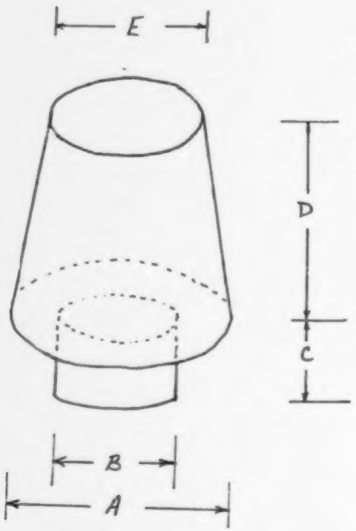
PART II-RECOMMENDED SOLUTION

A Motor Brush Assembly Tool Kit, Westinghouse P/N 3426B86 consisting of four (4) brush tools is recommended to satisfy the above Part I requirements. This kit is in use at Westinghouse for this purpose. A sketch of the items is provided as Figure II-1.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
51 (74979)	F-16 Antenna Motor Bush Assembly Tool Kit/3426B86		CONTR	USAF	
		ENG			
		PROC			

REF DI-S-3596A FIG 1A
Form DF-85

PAGE 1



Note: There are 4 items. Each has the same shape but dimensions "A" through "E" are different for each item.

F-16 Antenna Motor Brush Assembly Tool Kit

FIGURE II-1

AEROSPACE GROUND EQUIPMENT RECOMMENDATION DATA (AGERD)

LEVEL OF MAINTENANCE

CONTRACTOR	Westinghouse Electric Corporation
CONTRACT NO	F33657-75-0310
DOCUMENT NO	3426C87G01
END ITEM	F-16 Fire Control Radar
PAGE NO	1
REVISION NO	Original
DATE	

PART I - FUNCTIONAL ANALYSIS:

The F-16 Fire Control Radar Antenna radiates the transmitter amplified RF energy generated by the Low Power Radio Frequency (LPRF) unit and accepts return signals for delivery to radar receive circuitry. A large portion of the antenna is not included in the five Shop Replaceable Units (SRUs) contained within it, so that the entire antenna Line Replaceable Unit (LRU) will sometimes require return to the Depot for repair and overhaul.

Disassembly/assembly of various elements of the antenna is necessary during overhaul and to effect repairs. Special tools are needed to safely and efficiently perform several of these disassembly/assembly maintenance actions.

The F-16 Antenna array is sealed and during system operation is pressurized to ensure against arcing. Sealing is accomplished by covering the antenna array slots with a film bond. A means of reapplying this bond at the Depot during antenna repair or overhaul is required.

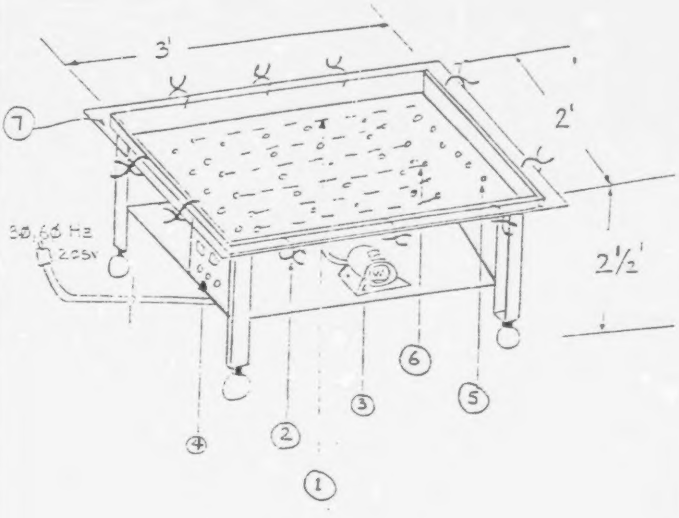
Part II - RECOMMENDED SOLUTION

A Vacuum/Heat Maintenance Stand, Westinghouse P/N 3426C87G01, is recommended to satisfy the above Part I requirements. This item is in use at Westinghouse for this purpose. A sketch of the item is provided as Figure II-I.

ITEM	NOMENCLATURE/PART NUMBER	CRITICAL			CAL
52 (74980)	F-16 Antenna Vacuum/Heat Maintenance Stand		CONTR	USAF	
		ENG			
		PROC			

REF DI-S-3596/S-124-2 FIG 1A

AEROSPACE GROUND EQUIPMENT RECOMMENDATION DATA (AGERD)



1. STRIP HEATERS
2. CLAMPS
3. VACUUM PUMP
4. CONTROL PANEL
5. VACUUM COVERS
6. PLATE & PLATEN
7. TEFLON & POLY VINYL ALCOHOL COVERS

F-16 ANTENNA VACUUM/HEAT MAINTENANCE STAND

FIGURE II-1

Mr. **DINGELL.** Thank you.
General Monahan.

TESTIMONY OF MAJ. GEN. GEORGE L. MONAHAN, JR.

General **MONAHAN.** Mr. Chairman, thank you.

The Air Force would like to make some brief opening comments; we just got the GAO report over the weekend so, obviously, we don't have a detailed response to that. However, we would like to provide a detailed response to the GAO report for the record at a later time, if that is acceptable.

Mr. **DINGELL.** The Chair will permit you to make a proper response, but, General, wasn't the Defense Department and the Air Force specifically briefed on this matter some 2 weeks ago?

General **MONAHAN.** No; we were not briefed on the report. The report was not prepared a few weeks ago. We did get some of the general results that came out of the investigations. The report was not prepared. We did not have specifics as to what the findings were.

Mr. **DINGELL.** You were briefed, though, on the content?

General **MONAHAN.** We were briefed on the content in a very overall, general sense. We told the GAO at that time that we did not agree with what they had told us during their brief meeting.

Mr. **DINGELL.** Did the Air Force make any inquiry at that time that you were briefed in regard to the findings of the General Accounting Office?

General **MONAHAN.** At that time we asked for a copy of the report. We were told that a copy of the report was not available and not even in draft, as a matter of fact, and would not be for some time.

Mr. **DINGELL.** I believe the records of the subcommittee will show that a copy of this document was sent to Secretary Weinberger on Wednesday last.

Did you receive it from the Secretary's office at that time?

General **MONAHAN.** I did not receive a copy directly from the Secretary's office. We did receive a copy, I believe it was Thursday or Friday, I think.

Mr. **DINGELL.** So, the Air Force did receive a copy then from the Secretary on Thursday or Friday of last week?

General **MONAHAN.** I cannot verify that one way or the other. I note that the General Accounting Office report, as I recall in reading it and in reading the letter of transmittal, I believe it said it was sent to this committee rather than sent to the Department of Defense.

Mr. **DINGELL.** The records of the subcommittee, I believe, will show that we, the subcommittee, sent a copy of this document to the Secretary's office on Wednesday of last week.

The Chair is going to recognize members for questions.

General **MONAHAN.** Mr. Chairman——

Mr. **DINGELL.** Do you want to make a statement, General?

General **MONAHAN.** Yes, if I may proceed——

Mr. **DINGELL.** You may consider yourself recognized.

General **MONAHAN.** Although we have not been able to review the report in detail, we would like to make some comments surrounding the particular procurement in question. This was part of the Air Force effort to develop depot level maintenance capability for the radar system on the F-16.

Over here you will see one of the radar antennas from the F-16's, that is just an antenna, it does not include the black boxes, but that is a $95,000 item. So, what we are talking about here is setting up approval, durable maintenance capabilty for $160 million worth of Air Force equipment, and that is why we go into a rather sophisticated and professional process in doing so.

I would like to stress that we are setting up a permanent depot, something that is going to be there well past the turn of the century. It is going to repair radar sets for not only the U.S. Air Force, but air forces throughout the free world.

That being the case, we are very careful about the types of tools that we provide to our technicians so that they may give proper repair to the equipment on an enduring basis. We don't use wooden pins, and we don't use coathangers, and we don't use pieces of milk cartons, as tools to do long-term overhaul maintenance on our radar systems.

We do, however, look at using the tools we already have on hand. For example, the equipment that we have already on hand at Ogden is worth more than $20 million to repair other radar systems for the F-15 and for the F-111, General Dynamics recommended that we use that.

There was a direct cost avoidance to the F-16 Program because that kind of recommendation was made. We finally get down to a point, however, when we have to buy special tools for very specific items such as this radar.

Those are arrayed before you right here, those in question in the GAO report. They are not complex. They look rather rudimentary but, I can assure you that they are built to very close tolerances, there are calibration requirements associated with them, and there is a sophisticated process involved in ensuring that those tools will do the job and do the job properly over a very long period of time.

Another point I would like to make. It is important to us that we establish this depot level repair capability as early as possible after introduction of a new weapons system into the Air Force.

In 1982 we had had production model F-16's deployed with our forces already for a period of about 2 years. We were trying hard to get our depot level capability on as soon as possible.

Mr. **Dingell**. Why is that important?

General **Monahan**. Well, to reduce dependency on the contractor. We have to fund his repair activity; and in that period of time we were paying the contractor about $400,000 a quarter, $1.6 million a year, to do the depot level repair capability for us, so we wanted to get this capability established as early as we possibly could.

The contractor also becomes a sole-source repair for us. So obviously we want to get away from that quickly.

I would like to talk specifically about one item that comes up in the report, the use of what is termed an unpriced not to exceed contract. I think unpriced is probably not a good description. Undefinitized would probably be a better description of this type of contract.

There is a reason for using it. In this case it saved us time and money to use this particular type of contract.

I would like to demonstrate that by showing you some data over here on a chart. [See p. 103.] This chart is a chronology of the events that lead to the final contract, the final price for the hardware items that we are talking about here today.

First of all, as was brought out in the report by the General Accounting Office, we started out with what we call a not to exceed price, an absolute limit on this particular effort to get these tools into the field for that amount of money, a little over $1.6 million. General Dynamics provided to us a proposal 2 months later for a fixed price type contract for that amount right there—$1.2 million.

Now the items that are concerned in the report are these 15 SERD's—let me give you some of the abbreviations here. WEC is Westinghouse Electric Corp., GD is General Dynamics. We got the proposal for those items, and you can see what that proposal price was.

Now at that stage of the game the Air Force could have decided to definitize the contract. If you definitize that contract at that period of time you are probably going to definitize at something around that, probably just a little lower—$1.2 million.

Once that price is established that is the price that we are going to pay. If that is the case you sustain a very high risk of paying excess profits on the contract.

In April 1983, after we had the opportunity to look very carefully at the engineering work that had already been done, and also to look very carefully at the price, the terms, and conditions on the contract, our people at the Air Force plant representative office, at General Dynamics, notified the contractor we thought that this price was excessive and we told him that we wanted him to repropose.

The contractor indeed did so. This is why it took us more than 180 days to negotiate this contract. We could have done it in 80 days, but any contracting officer will tell you that he should not negotiate under that kind of a date deadline.

If he does so he is forced into negotiating a higher price than he wants to get to. Subsequently, we finally got the General Dynamics firm price negotiated in March 1984.

You can see that it was for about one-half the price originally proposed for the items over here, these eight items; and just a fraction of the price, on the items for which we bought drawings.

One other point that I would like to make. Another possibility would have been to hold off awarding a contract until it could be completely definitized to our satisfaction which probably would have been out, we don't know exactly when, but we got it done finally in March 1984.

So, we would have gone 19 months, from September 1982 to March 1984. There is another period of time where we have to tack on the additional 19 months of effort on the part of the contractor—we would have to use his depot instead of our own, costing us about $2½ million.

To us that would not have been a very good deal. We think that it worked out much better in this fashion. I think that helps explain some of the financial aspects which surrounded this.

We would like to be able to describe also how it is that you get into the price—why is it that this price is right, wrong, or indifferent, and also talk a little bit more about the need.

General Yates researched that rather carefully; and I would like for him to take on that part.

TESTIMONY OF BRIG. GEN. RONALD W. YATES

General **Yates**. Mr. Chairman, what I would first like to do is start with a chart which depicts in a very general fashion this process that we are talking about. [See p. 104.]

When we decided that we needed a special piece of support equipment, in other words, not a common hand tool, not something you can go to the hardware store and buy to do the job, once we make that decision we enter this general process.

There may or may not be design. There is drafting to military specifications so that we can reprocure this or compete it, test requirements data, we get down and manufacture it, we go through the compatible testing, but this is the key.

We get two things in the Government. One we get hardware, which I am going to talk about in just a moment, and that is what we tend to focus on, is what the piece of equipment costs. But the other thing we get is reprocurement data, the test results, which is what we use to write the technical orders to tell a technician how to use the tool.

It doesn't do us any good to ship F-16 tools to a depot and say use these as you see fit. They have to have a technical order.

The calibration requirements, these gauges measure to a thousandth of an inch. They have to be routinely calibrated or we will damage the antenna.

So what we are buying here, are one of a kind items. What we have done is we went out and we purchased these tools to maintain the depot with the exception of the large oven, which is depicted in the GAO report, and with the exception of 15 other items that are this identical item here, which is called an RF load because you need 16 of these to repair two radar sets.

What I have my arms around here is the universe of radar special equipment to maintain the antenna. This is the entire universe.

This is all the equipment we are buying to maintain the $53 billion F-16 radars thoughout the world. There is not one per aircraft, one per squadron, one per wing, that is it. You are looking at all of them.

What I would like to do, this is the generic process, I would like to take this specific item and show you how the costs breakdown. This is the last chart I will show you, sir. [See p. 105.]

To begin with the going-in position is that a manufacturing aid already exists. There seems to be some misunderstanding about that with the General Accounting Office. We were under no illusions that such an aid did not exist.

In fact, we get a certification from both Westinghouse and General Dynamics that a simple tool, the tool is in use at Westinghouse for the purpose that we are after. That is our certification that we, in fact, will probably also need the tool.

So, that is the going-in position. And the dollars on this contract that we paid for that are zero.

The next thing is the engineering review and test. We don't use the word "design" because in truth when you have a problem and you conceive of a solution to that problem, that is design and that was already done when we conceived of the manufacturing aid.

Now we have to look at an aid which is good for maybe one or two people to use in a special interim contractor support area back at the manufacturer, at Westinghouse, and we have to prepare a device which can be used by a number of technicians at Ogden, our depot, through the remainder of this century. When we take this engineering review, and this is the first time the engineers have reviewed the manufacturing aid, we look at the manufacturing aid, determine how or if it needs to be modified to meet Air Force requirements, and we design a test to make sure it can be used by any technician with a technical order, that it does everything the Air Force is buying the tool for.

And the engineers then write the test report and they review the engineering drawings to ensure that they meet military specifications. These man hours were logged by Westinghouse.

They have been audited by the Air Force auditing agency, they have been confirmed by your GAO auditors on this review. These are the hours audited.

The price of these hours is not a matter of controversey. They are in accordance with the rates established by the Government and Westinghouse.

For 92 engineering man hours at Westinghouse we paid $3,242. Then we create procurement drawings, this is the way, should one of these be lost or become unserviceable, that we can make it ourself, or reprocure it with another agency. It took 41 hours.

We questioned whether or not that was a reasonable number, so we took one of the drawing packages in this group and sent it to a civilian contractor and a government agency. Westinghouse said it took 37 man hours to do the drawings; a civilian firm said it would take them about 30; the Government agency said 40. We thought, therefore, based on that data point that these are probably reasonable hours.

Forty one hours of engineering time to make those drawings cost the Government $1,172. There is a manufacturing plan that goes with this.

It has to be produced on time; they have to decide if they are going to buy things outside or not.

What about the material going into this?

If they procure it outside of Westinghouse that has to be done on a purchase order.

We looked at the purchase orders, they logged 8 man hours. I asked our people, and they said it would take us about 8 hours.

How can I tell you what the cost of each individual item is? I am talking about this item. How can I tell you that?

Because we keep up with all these man hours and all these costs on a daily basis.

Here are the cost reports that we have for the eight items that we are talking about here. This cost report is also in that 40 man hours and that 40 man hours costs $1,372.

Right now we haven't built anything, and we have spent $5,786, and that is the point that we were making earlier. If we decided to do this with wooden dowels and still put it through the pedigree process, we have already spent that much.

So, we spent $47 on material and we spent 16 man hours, or $533 to machine the item; so the value of this item right here is $580.

The quality assurance that goes with ensuring that the test is properly conducted, that the item is properly manufactured, and that the report meets Air Force specifications turned out to be 19 hours, it cost $647. At the time of the negotiations the item was not complete, not totally complete.

The estimate to complete this was $247. Then Westinghouse has an overhead and a profit rate which, in fact, is established with the Government and there isn't any fudging on that. That came out to be $1,843.

It is not fair to say they got $1,843 on this item because a product that Westinghouse has and invests in in engineering and in draftsman and in manufacturing, and they get profit on that; and that is the way we do business in this country.

The Government then bought the item from General Dynamics, the overhead and profit on the same item was $2,389. And, so, the total bill to the Government was $11,492.

I want to emphasize one more time that this cost $580, and it is not accurate to refer to this $11,000 cost as the cost of this item.

Should we destroy this or lose it, the price to produce another one of these is what I have here in blue, and we couldn't do that if I didn't have the drawings; and we couldn't do it if I didn't have the technical orders; and we couldn't do it if I hadn't completed the test.

Sir, that completes what I had to say in terms of introduction.

[The charts referred to follow:]

CHART 1

PRICE HISTORY - 24 SERDs

DATE	NATURE OF PRICE	8 WEC SERDs BOUGHT	7 WEC SERDs NOT BOUGHT	9 NON-WEC SERDs	TOTAL
SEP 82	NTE				$1,685,558
NOV 82	GD FIRM PRICE	$499,406	$82,232	$ 690,832	$1,272,470
AUG 83	NEGOTIATED	—	—	$ 586,197	—
JAN 84	GD FIRM PRICE & NEGOTIATED	—	$ 176	—	—
FEB 84	GD FIRM PRICE	$254,707	—	—	--
MAR 84	NEGOTIATED	$249,462	—	—	—
SUMMARY	NEGOTIATED	$249,462	$ 176	$ 586,197	$ 835,826
			(4 DRAWING PKGS)	(8 NON-WEC SERDs)	

CHART 2

DESCRIPTION OF SERD PROCESS

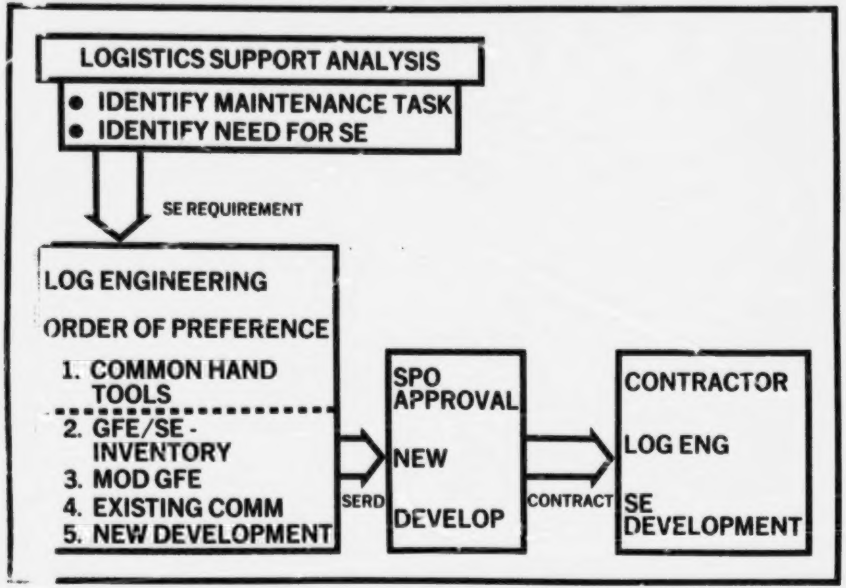

LOGISTICS SUPPORT ANALYSIS
● IDENTIFY MAINTENANCE TASK
● IDENTIFY NEED FOR SE
SE REQUIREMENT
LOG ENGINEERING
ORDER OF PREFERENCE
1. COMMON HAND TOOLS
2. GFE/SE - INVENTORY
3. MOD GFE
4. EXISTING COMM
5. NEW DEVELOPMENT
SERD
SPO APPROVAL
NEW
DEVELOP
CONTRACT
CONTRACTOR
LOG ENG
SE DEVELOPMENT

CHART 3

ELEVATION MOTOR PULLER

	HOURS	DOLLARS
EXISTING MANUFACTURING AID EXISTS	0	0
ENGINEERING REVIEW AND TEST	92	3242
CREATE REPROCUREMENT DRAWINGS	41	1172
MANUFACTURING PLAN	40	1372
BUY MATERIAL	—	47
MANUFACTURE ITEM	16	533
QUALITY ASSURANCE	19	647
ESTIMATE TO COMPLETE	—	247
WEC OVERHEAD/PROFIT	—	1843
GD OVERHEAD/PROFIT	—	2389
GRAND TOTAL		$11,492

General MONAHAN. And that concludes our opening remarks on the part of the Air Force, Mr. Chairman.

Mr. DINGELL. We have an interesting question here.

Did anybody from the Air Force go up to talk to Westinghouse about the equipment that they used to repair these facilities?

General MONAHAN. Absolutely, Mr. Chairman.

Mr. DINGELL. Did anybody from the Air Force go up and look at the tools that Westinghouse used to repair these devices?

General MONAHAN. Mr. Chairman, that is where the process starts. The first line says existing manufacturing aid exists.

We go and we find out what it is that Westinghouse is using to do that particular task. We are required to do that; Westinghouse is required to certify to us that what they eventually recommend to us is what they are using or the equivalent.

We find out what they are using, and then we go through these various steps from ensuring review, and test all the way down. And that is what it takes to make those items, or something very close to it that Westinghouse is using, and enter that into our maintenance system and into the Government inventory.

Mr. DINGELL. Well, General, can you explain to me why you went to General Dynamics rather than going to the subcontractor on this matter?

General MONAHAN. Be happy to, sir; and that is an excellent question. The reason for doing it is this.

We are establishing a depot repair capability at Hill Air Force base in Utah for the F-16. That is what we are involved in. We make General Dynamics responsible for that implementation.

In the Air Force we know how to run that depot. We know how to maintain equipment in it.

We don't know how to design that equipment. We don't have design engineers, development engineers to do that kind of thing. Therefore we hire General Dynamics to do that particular task.

Mr. DINGELL. Wasn't Westinghouse the manufacturer of the radar system?

General MONAHAN. Yes.

Mr. DINGELL. Why didn't you go directly to them?

General MONAHAN. Because General Dynamics is charged with the responsibility, and is being paid for ensuring that these tools, indeed, do the job. That the tools are durable. That the tools are within tolerance. That we have the reprocurement drawings; all of those deliverables that you saw on the chart that General Yates showed a moment ago.

Mr. DINGELL. Are you telling me that the people at Westinghouse were incompetent to do that?

General MONAHAN. No, certainly not.

Mr. DINGELL. Then why did you not go to them?

General MONAHAN. Because General Dynamics had the responsibility. We were under contract with General Dynamics to make this depot happen.

General Dynamics may go anywhere they want to get the necessary work done under that condition.

Mr. DINGELL. They also loaded an overhead and profit item on that that I can't see——

General YATES. $2,389.

Mr. **Dingell**. If you had gone direct to Westinghouse, you wouldn't have had to pay that and you would have gotten the same equipment.

General **Monahan**. We may or may not have gotten the same equipment. I must stress we contract with General Dynamics to do a job that we do not have the organic capability to perform within the Air Force itself.

Mr. **Dingell**. You bought the drawings and then you produced a number of items yourself. Mr. Sikorski mentioned this. How does that jive with the comments that you have just made?

General **Monahan**. Because in the case of those four items where we bought the drawings only, we had determined after learning what the items were that they were items that did not have close tolerances, did not have calibration requirements and were easy to make and we trusted that those would work simply by procuring the drawings, without procuring any test data or calibration requirements, that indeed that would do the job.

Mr. **Dingell**. These items are the puller height gauge, the tape block tool, the hexagon wrench, and the alignment pin; is that right?

General **Monahan**. I believe that is the four.

Mr. **Dingell**. When did you arrive at the judgment that you were going to produce these yourself? After you got bad vibes over the set; is that right?

General **Yates**. Mr. Chairman, I believe that was in January 1984 that we decided to only procure those drawings.

Mr. **Dingell**. Senator Roth's hearing was in November 1983, was it not?

General **Yates**. I think that might be true. I don't know.

Mr. **Dingell**. The answer is it was. However, very shortly thereafter, the Air Force decided that it could function simply with the drawings on these and do its own manufacturing, is that not so?

General **Yates**. Yes, sir. That is correct.

Mr. **Dingell**. How am I to not be driven irresistibly to the conclusion that the Air Force's determination was tied in with those hearings as opposed to some other event?

General **Yates**. Mr. Chairman, I think that the answer to that is that in fact these items, as you know, have been the subject of widespread investigations.

Mr. **Dingell**. Unfavorable publicity for the Air Force.

General **Yates**. That is correct.

Mr. **Dingell**. So what happened is the Air Force got hurt and then it decided, "Well, we are going to do these things ourselves." Previously it had not done so.

General **Yates**. In the case of these items, in the case of those four items, we looked at those items and determined that they were simple enough for us to do the verification process ourselves.

Mr. **Dingell**. When did the Air Force arrive at that decision and why?

General **Yates**. January 1984.

Mr. **Dingell**. Which is 3 years almost to the day after you decided that you had to have Westinghouse do this for you.

General **Yates**. Yes, sir.

Mr. DINGELL. What was the urgency that required this 3-year rush on the part of the Air Force?

General YATES. Sir, I would like to point out that when we evaluated that, the Government paid $44 for each of those drawings. That is the extent of what the Government paid for those four tools. Then we manufactured them ourselves.

General MONAHAN. If you will recall, Mr. Chairman, the price, most of the price associated with the tools is not the labor and material of actually physically making it, but rather the rest of the activity that you see displayed up there.

Mr. DINGELL. The gentleman from Minnesota.

Mr. SIKORSKI. The point is you took us through the workings of this wonderland and said it was a great system and that it was cost effective and the taxpayers got what they paid for and they got a great bargain. But there are four tools that were produced just by getting the drawings and producing them yourself and I think, if my inkling is right, part of your response is these tools are generically different from the other ones that were purchased under this system and even though one cost $91, the most expensive was $50 as opposed to the most expensive of $290,000, and the cheapest was $2,116.

Tell me how these valve wrenches are different from a couple of the others. You manufactured a tape lock tool and bought something that was duplicative under this system. You bought the pulley puller that had a Phillips screw on it that you couldn't get the torque through this system. This great system produced something that didn't work.

You also produced something that is lost and you produced something that isn't even out of the crate because there are no instructions, through that system.

Mr. DINGELL. Let's come around here and let's look at some of the things that were procured through the system. First, Mr. Sikorski mentions the pulley puller. The pulley puller that you bought through the system didn't work, did it?

General YATES. The pulley puller that we bought through the system, in fact, when constructed to the drawing——

Mr. DINGELL. Didn't work.

General YATES. Would work, sir, but in fact when it was delivered, the pulley puller was delivered, it needed a hex head bolt on the top and it had a Phillips head bolt and we had to change the bolt.

Mr. DINGELL. How much did you pay to have the hex head replaced with a screw?

General YATES. We didn't pay anything.

Mr. DINGELL. But it was done in house, was it not?

General YATES. Yes, sir. It was.

Mr. DINGELL. So it didn't work when you got it and the cost of that as we observe here was $9,000—it started out at $10,630, it went then to $13,717; it went to $9,007, and finally General Dynamics paid $7,009 to Westinghouse and the price negotiated by the Air Force was $8,832.

General YATES. Mr. Chairman, I would like to say that General Dynamics refunded all that money but $370 to the U.S. Air Force.

Mr. DINGELL. Did you agree with that refund?

General **Yates**. That money was refunded to the Secretary of the Air Force, sir. It was volunteered. We didn't turn it down.

Mr. **Dingell**. It was volunteered?

General **Yates**. Yes, sir.

Mr. **Dingell**. When was it volunteered?

General **Yates**. I don't know the exact date, Mr. Chairman.

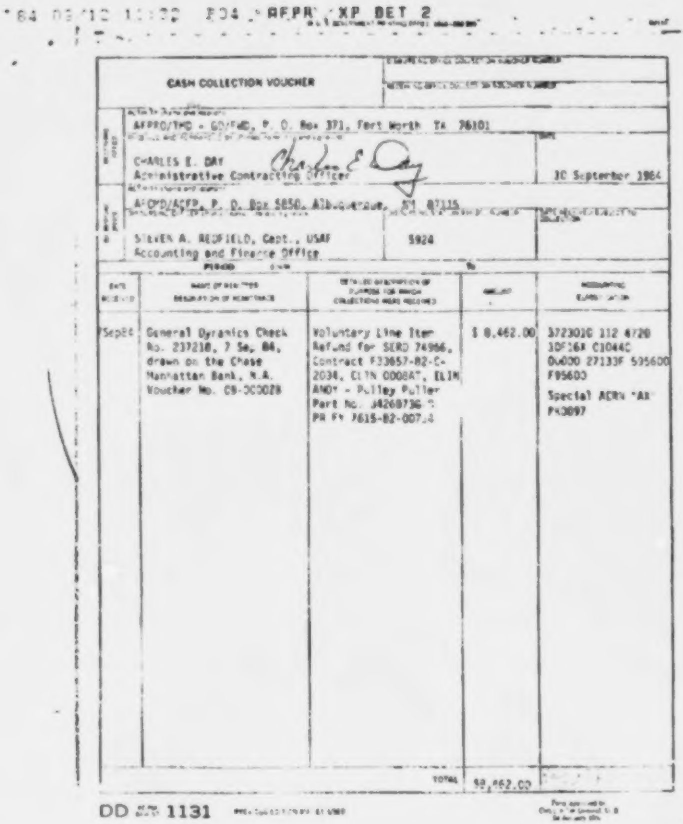
Mr. **Dingell**. Would you submit——

General **Yates**. I would submit that for the record. Yes, sir.

Mr. **Dingell**. Mr. Wood, can you tell us——

Mr. **Wood**. I would be delighted to submit it for the record, sir.

[The information follows:]



'84 09/12 11:32 204 AFPR XP DET 2

CASH COLLECTION VOUCHER

AFPRO/TMD - GD/FWD, P. O. Box 371, Fort Worth TX 76101

CHARLES E. DAY
Administrative Contracting Officer
Charles E. Day

10 September 1984

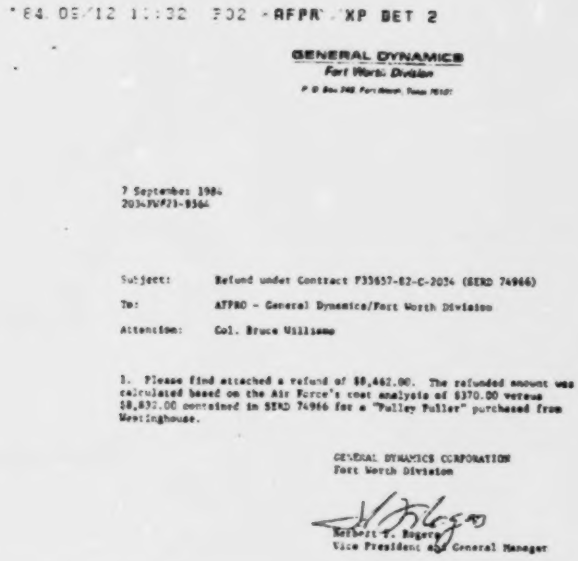
AFCMD/ACFP, P. O. Box 5850, Albuquerque, NM 87115

STEVEN A. REDFIELD, Capt., USAF
Accounting and Finance Office

5924

DATE RECEIVED	NAME OF REMITTER DESCRIPTION OF REMITTANCE	DETAILED DESCRIPTION OF PURPOSE FOR WHICH COLLECTIONS WERE RECEIVED	AMOUNT	ACCOUNTING CLASSIFICATION
7Sep84	General Dynamics Check No. 237218, 7 Sep 84, drawn on the Chase Manhattan Bank, N.A. Voucher No. C8-0C0028	Voluntary Line Item Refund for SERD 74966, Contract F33657-82-C-2034, CLIN 0008AT, ELIN A00Y - Pulley Puller Part No. 34268736-1 PR FY 7615-82-00734	$ 8,462.00	5723020 112 4720 3DF26X C1044C 0u000 27133F 595600 F95600 Special ACRN "AX" FK3097
		TOTAL	$8,462.00	

DD 1131



'84 09/12 11:32 P02 AFPRO/XP DET 2

GENERAL DYNAMICS
Fort Worth Division
P.O. Box 748, Fort Worth, Texas 76101

7 September 1984
2034/FW#73-9364

Subject: Refund under Contract F33657-82-C-2034 (SERD 74966)

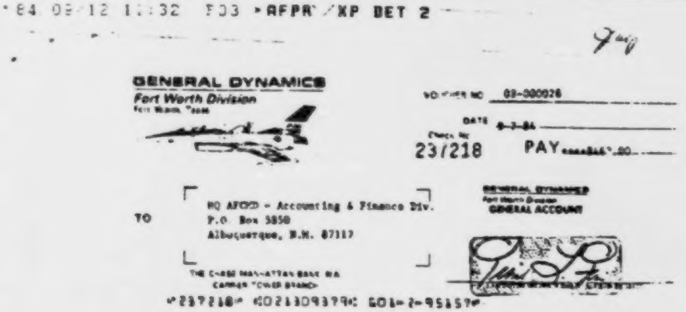
To: AFPRO - General Dynamics/Fort Worth Division

Attention: Col. Bruce Williams

1. Please find attached a refund of $8,462.00. The refunded amount was calculated based on the Air Force's cost analysis of $370.00 versus $8,832.00 contained in SERD 74966 for a "Pulley Puller" purchased from Westinghouse.

GENERAL DYNAMICS CORPORATION
Fort Worth Division

H F Rogers
Herbert F. Rogers
Vice President and General Manager



'84 09/12 11:32 P03 AFPRO/XP DET 2

9-7

GENERAL DYNAMICS
Fort Worth Division
Fort Worth, Texas

VOUCHER NO 09-000026

DATE 9-7-84

Check No
23/218

PAY ****846[illegible].00

TO
HQ AFCMD - Accounting & Finance Div.
P.O. Box 5850
Albuquerque, N.M. 87117

GENERAL DYNAMICS
Fort Worth Division
GENERAL ACCOUNT

THE CHASE MANHATTAN BANK NA
[illegible]

⑈237218⑈ ⑆021309379⑆ 601-2-95157⑈

Mr. SIKORSKI. Mr. Chairman—on that point, General, you didn't agree with that. You didn't think that was right that they should have had to pay that money back; isn't that correct?

General YATES. Mr. Sikorski, the straightforward answer is that in fact they spent the cost incurred, we knew that.

Mr. SIKORSKI. Did you hear the question?

Mr. DINGELL. Is the answer to that yes or no? Did you agree or did you not agree?

General YATES. I did agree. We accepted the refund, sir.

Mr. DINGELL. When did you agree?

General YATES. When the refund was offered to the Air Force, we agreed to accept it.

Mr. DINGELL. Had that been your position earlier to that time?

General YATES. No, sir.

Mr. DINGELL. It had not been?

General YATES. No, sir.

Mr. DINGELL. When did you first agree?

General MONAHAN. When the refund was received, we agreed to accept the refund.

Mr. DINGELL. When General Dynamics returned the money, you agreed that you should accept it?

General MONAHAN. Yes, sir.

Mr. DINGELL. Prior to that time, you did not agree?

General MONAHAN. No.

Mr. DINGELL. It took a great deal of time to get that answer.

When the GAO interviewed you, General Yates, you said you did not agree with the Secretary of the Air Force's letter and you said that the pulley puller should have cost only a few dollars and that as soon as Air Force officials found out about the price, the Air Force asked and received a voluntary refund; is that correct?

General YATES. That is not correct. I have never discussed, to the best of my recollection, the pulley puller with the GAO. For sure, I never said I disagreed with the Secretary of the Air Force.

Mr. DINGELL. The GAO also informed the subcommittee you said you did not agree with the refund and only requested it when you were ordered to do so; is that correct?

General YATES. Sir, I do not ever recall discussing this subject with the GAO.

Mr. DINGELL. All right. The GAO also informed the subcommittee you said that the data submitted to the Headquarters U.S. Air Force was the same as presented to the GAO and did not support a refund request; is that correct?

General YATES. No, sir. It is not.

Mr. DINGELL. In fact, you were supposed to have said to the GAO that General Dynamics is entitled to the refund that it made; is that correct or not correct?

General YATES. Sir, I have not discussed this with the GAO.

Mr. DINGELL. Mr. Quicksall, will you come forward, please?

Mr. Quicksall, you have just been sworn, so you may consider yourself to continue being under oath.

Will you sit down over there on the end and tell us what are the facts with regard to the interview of General Yates.

Mr. QUICKSALL. The interview with General Yates was in Dayton, OH, I think in February, and I was not at that meeting.

However, I know there are GAO people in the audience who were at that interview——

Mr. **Dingell**. I gather that Ms. Nancy Kingsbury is the GAO agent?

Mr. **Quicksall**. Yes, sir. I believe she is in the audience.

Mr. **Dingell**. Ms. Kingsbury, are you here, please?

Ms. **Kingsbury**. Yes, sir.

Mr. **Dingell**. Would you come forward, please.

General **Yates**. Mr. Chairman, may I say something?

Sir, I certainly do recall having an interview with Ms. Kingsbury. I am sorry I have not met Mr. Quicksall before and in my comments directed to you, I was addressing the GAO presentation here today.

Mr. **Dingell**. We will ask Ms. Kingsbury about her recollection of the discussion and then we can perhaps get a better appreciation of what the facts are here.

Ms. Kingsbury, you have heard the comments of the Chair as we have gone through the preparation of the witnesses. Do you have objection to appearing before the subcommittee today?

Ms. **Kingsbury**. No, sir.

Mr. **Dingell**. Do you have objection to appearing under oath?

Ms. **Kingsbury**. No, sir.

Mr. **Dingell**. Do you desire to have counsel present to advise you?

Ms. **Kingsbury**. No, sir.

[Witness sworn.]

Mr. **Dingell**. You may then consider yourself under oath and if you will take a seat here, please and give the subcommittee your full name. We will have a few questions for you.

TESTIMONY OF NANCY KINGSBURY, ASSOCIATE DIRECTOR, U.S. AIR FORCE/NASA SUBDIVISION, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE

Ms. **Kingsbury**. I am Nancy Kingsbury, Associate Director in the Air Force/NASA Subdivision, National Security and International Affairs Division of GAO.

Mr. **Dingell**. Did you interview Gen. Ronald Yates on the February 21, 1985, at approximately 9 o'clock in the morning?

Ms. **Kingsbury**. I don't recall the exact date. That is approximately my recollection. Yes, sir.

Mr. **Dingell**. Who was present at the time of that interview?

Ms. **Kingsbury**. Myself; Mr. Brad Hathaway, who was the group director involved; Mr. Linus Brackman, who was the Dayton office representative of GAO; and I believe Mr. Harold Andrews was also in that discussion representing GAO.

Mr. **Dingell**. Did you interview General Yates about the pulley puller that we have been discussing?

Ms. **Kingsbury**. We interviewed General Yates in general about the work we were doing. He presented us a briefing which included a detailed analysis of the costs associated with the pulley puller as he understood them, which was fairly similar to the one that he just presented this committee only about a different item.

Mr. Dingell. Did General Yates say that he did not agree with the Secretary of the Air Force's letter that states that the pulley puller should have cost only a few dollars in the course of that interview?

Ms. Kingsbury. In the course of that interview, he clearly stated the accumulation of costs for these items and how the system works and my recollection is that he did not feel that the refund particularly reflected that reality. I do not specifically, frankly, remember him saying that he disagreed with the Secretary of the Air Force. He was a very professional briefer at the time and I don't recall that.

Mr. Dingell. Did he also say that as soon as the Air Force officials found out about the price, the Air Force asked and received a voluntary refund?

Ms. Kingsbury. It is my recollection he told us that, sir; yes.

Mr. Dingell. Did he also say that he does not agree with the refund and only requested it when ordered to?

Ms. Kingsbury. I do not personally recall him saying that. We have a record of that interview written up by the people in the meeting and I did not expect to have this come up and have not reviewed that record recently.

Mr. Dingell. Would you please do so because I think——

Ms. Kingsbury. I will be happy to do so if we have a copy of it.

Mr. Dingell. I am quoting to the best of my knowledge from the notes that you compiled at the time.

Will you submit those notes to the subcommittee, please.

Ms. Kingsbury. Yes, sir.

Mr. Dingell. You also indicated that General Yates said the data submitted to the Headquarters, U.S. Air Force was the same as presented to the GAO and did not support a refund request.

Ms. Kingsbury. Would you repeat the question.

Mr. Dingell. You indicated in your notes that General Yates had said that the data submitted to the Headquarters, U.S. Air Force was the same as presented to the GAO and did not support a refund request.

Ms. Kingsbury. It was our understanding that that data had been submitted to Headquarters, U.S. Air Force. The question of requesting a refund, I believe, was made elsewhere—the decision.

Mr. Dingell. You also indicated that General Yates had said or indicated that he believes that General Dynamics is entitled to the refund that it had made to the Department of Defense.

Ms. Kingsbury. This is a number of months ago. That characterization is not inconsistent with the general view that the costs were accumulated in accordance with the way this system works. I do not specifically remember him saying that, but I can't go beyond that.

Mr. Dingell. Very well.

The Chair is going to recognize the members of the subcommittee for questions. The Chair will pursue these matters at a further time.

The Chair recognizes the gentleman from Oregon, Mr. Wyden.

Mr. Wyden. Thank you very much, Mr. Chairman.

General Yates, the Baltimore division of Westinghouse, the 13th largest Defense contractor, $1.8 billion worth of sales in 1984, built

APG-66, a more advanced APG-68 radar for the F-16 fighter aircraft, similar radar for the B-1 bomber. In your opinion, how well managed and what level of quality control has the Air Force experienced on the Westinghouse radar program?

General **YATES**. On the APG-68 radar program, we have had a great deal of problem with the quality at Westinghouse and, as a matter of fact, we are currently withholding a great deal of money from Westinghouse, over $150 million——

Mr. **WYDEN**. That was the action that was taken in 1983, where you cut off about 93 percent of their progress payments?

General **YATES**. Sir, that is a cumulative number to date, so it started in 1983 and it has been accumulating since then, so it is now over $150 million.

Mr. **WYDEN**. Isn't this the single largest progress payment hold-up action that has ever been taken by the Air Force, this $150 million cumulative hold-up?

General **YATES**. Sir, I don't know the answer to that.

Mr. **WYDEN**. Well, why did the Air Force secretly cut off these progress payments? It was an action in November 1983, the first public disclosure was in September 1985. Was this because you didn't want any adverse publicity for the contractor?

General **YATES**. Not at all, sir. There wasn't any secrecy involved in this. The reduction in progress payments is contained in all the records. As a matter of fact, I understand that it was in testimony to the Congress last April. I have reported it throughout the whole chain of command, through all the normal reporting procedures, so there wasn't any secrecy involved in it, sir.

Mr. **WYDEN**. Well, it certainly wasn't publicly known or noticed. It might have been in a variety of different kinds of internal documents, but it certainly wasn't publicly known.

Has Westinghouse resolved the technical and manufacturing problems on the APG-68 radar?

General **YATES**. They have come a long way toward resolving the problems. We have made a lot of progress. They are not totally resolved to date, which is why we are still withholding the money from them.

Mr. **WYDEN**. What the subcommittee wants to know, General—we have a whole series of memos that you and others in the Air Force have written, some as late as August 23, 1985. One talks about 44 percent overruns, 75 percent rejection rates for the radars because they don't work. I have a memo that you signed that says "The problems are more deep rooted than we thought." I could go on and on.

At one point you mention, "It is evident that the Westinghouse management at the lab is deficient in the ability to produce product that meets contract requirements." We want to know what is going on at Westinghouse.

Have you issued a cure notice to the company to protect the taxpayers' interest in the event that the contract should be terminated?

General **YATES**. Sir, I have protected the taxpayers' interest. I have withheld $150 million from the contractor. In order to get all of the money back, he will have to correct any deficiencies that are in the radar at his own expense and return the radars to the Air

Force. The taxpayers' interests have been, in this case, completely covered.

Mr. **Wyden**. You haven't issued any cure notice or considered contract termination—you feel that the taxpayers are just covered in spite of the fact that there are 44 percent overruns and you go on to say, for example, "There are no quick fixes, the Air Force discontinues acceptance of all products."

General **Yates**. Yes, sir, I do feel we have protected the taxpayer.

Mr. **Wyden**. Well, it certainly doesn't seem to me, given all those extraordinary comments—let's go over each one of them specifically. Here is a memo that you wrote: "I did not realize how deep rooted the problem was. I recognize now that there is no quick fix available to address the numerous process equipment procedural problems associated with this task."

General **Yates**. That is accurate. That is why I am withholding the $150 million.

Mr. **Wyden**. Well, I would ask unanimous consent, Mr. Chairman, that that be inserted.

Mr. **Dingell**. Without objection, so ordered.

[The memorandum follows:]

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS AERONAUTICAL SYSTEMS DIVISION (AFSC)
WRIGHT-PATTERSON AIR FORCE BASE OHIO 45433

06 AUG 1985

REPLY TO ATTN OF: YP

SUBJECT: Printed Wiring Assembly Baseline Corrective Actions

TO: Westinghouse Electric Corporation
Attn: Mr Emmett Wheeler, MS 225
P.O. Box 746
Baltimore MD 21203

1. When I charged you three months ago to clean up the quality problems associated with printed wiring assemblies (PWA) and to get our LRU deliveries up to expected rates, I did not realize how deep rooted this problem was. I recognize now that no quick fix is available to address the numerous management, process, equipment and procedural problems associated with this task, and that extensive corrective action has been identified, both by your people and mine.

2. I have attached a summary of proposed actions that resulted from our 24-26 April 1985 visit to the Electronic Assembly Plant (EAP) and our subsequent visit to other PWA manufacturers. In addition to this list, actions have been generated by WEC's EAP Task Force, AFPRO concerns (Rev, C dated 6-4-85), and by Modern Technologies Corporation (MTC) visit of 13-14 June 1985. Because of the significance of these actions, I believe it important to capture them all in a baseline tracking system to insure that they are not lost in the shuffle.

3. Request you establish this baseline tracking system and be prepared to brief me on these actions and status not later than 23 August 1985. If assistance is required, please contact Lt Col Milensky or Mr Terry Lennon at (513) 258-4544.

SIGNED

RONALD W. YATES
Brigadier General, USAF
Deputy Commander
Deputy for F-16

1 Atch
Proposed Actions

Mr. WYDEN. It seems to me, General Yates, given the wide variety of comments that were written by the Air Force, that that certainly was not sufficient. We could go back through specific ones and perhaps you would like to comment further. On August 12, 1985, the Air Force wrote Westinghouse, deficiencies were noted in the area of safety, quality, cost data, discipline, and quality procedures.

On August 23, 1985, a memo was written to Westinghouse from Donald Spalt, 14 Air Force deficiency reports generated since January 1, 1985, it's evident that Westinghouse management is deficient in the ability to produce product that meets contract requirements. As a result of this review, the governmnent will discontinue inspection and acceptance of product produced by the ATL facility.

Do you have any facility?

General YATES. Sir, I don't have those letters in front of me. I am really not qualified at this point to talk about them.

Mr. WYDEN. You, of course, are familiar with them?

General YATES. I am not familiar with all of those—with that correspondence, no, sir.

Mr. WYDEN. You——

General YATES. Certainly I am with the ones I wrote.

Mr. DINGELL. We will make copies of these memorandums available to you. Staff will come over and provide them to you.

But did you explain about 44 percent overruns, General?

General YATES. Sir, the 44 percent overrun number is at this instance——

Mr. DINGELL. I beg your pardon?

General YATES. The 44 percent overrun number at this instant is not a number that is familiar to me. I am not saying it isn't—I am not saying it is true or false, I am just saying it doesn't ring a bell, 44 percent overrun doesn't.

Mr. DINGELL. How about 45 percent rejection rate in the radars because they do not work?

General YATES. We have had some—in the course of say the last year, we have had some high rejection rates of total radar sets, but I don't believe it has ever been that high. But it has been that high in terms of printed wire assemblies, that is, individual subcomponents. I am not saying those numbers are not true, Mr. Chairman. I am just saying I am—I don't know exactly what the context there is.

Mr. DINGELL. Didn't you observe that the problems are more deep rooted than we thought?

General YATES. Yes, sir, I am familiar with that.

Mr. DINGELL. And there are no quick fixes?

General YATES. Yes, sir.

Mr. DINGELL. And in consonance with this, the Air Force discontinued acceptance of all product identification of quality, manufacturing, and engineering deficiencies; isn't that right?

General YATES. We did not discontinue accepting all products in the F-16 program.

Mr. DINGELL. You further pointed out, I am quoting, "It's evident that Westinghouse management at the lab is deficient in the ability to produce product that meets contract requirements." Isn't that right?

General **Yates**. Yes, sir.

Mr. **Dingell**. Have you issued a cure notice to Westinghouse to protect the taxpayers' interest in the event that the contract should be terminated?

General **Yates**. I have not issued the cure notice. I have withheld $150 million.

Mr. **Dingell**. I beg your pardon?

General **Yates**. I have not issued the cure notice, I have withheld $150 million from them.

Mr. **Dingell**. What is the difference between the withholding of $150 million—$150 million that Westinghouse can go in and sue? A cure notice means the Government has a defense based on failure of Westinghouse to comply, does it not? Isn't that the difference between the two actions?

General **Monahan**. Mr. Chairman, I don't know technically the difference between the two actions but the most severe thing it seems to me that we can do when a contract is in a situation of producing hardware that either is not up to our schedule or somehow or another not up to our standards is to withhold progress payments. That hits right in the pocketbook. That is the hardest part. I think General Yates' actions in this case are exactly the kind I would have taken.

Mr. **Dingell**. What is the answer, though, to the question that was asked? What is the difference between a cure notice and a withholding?

General **Monahan**. I don't know the technical difference, Mr. Chairman.

General **Yates**. I don't either.

General **Monahan**. I would have to submit it for the record.

[The information follows:]

Question. What is the difference between a cure notice and withholding progress payments?

Answer. A cure notice is a part of the process of terminating a contract for default which is the ultimate method of dealing with a contractor's unexcused failure to perform in accordance with the contract requirements.

A cure notice is issued to a contractor when the contractor fails to perform any of the provisions of the contract, or so fails to make progress as to endanger performance of the contract. It usually requires the contractor to "cure" such failure within 10 days after receipt of the notice. If the contractor fails to "cure" the problem, the contract may be terminated.

The government rarely terminates contracts for delays or where contractors are able to demonstrate the ability to correct the problem. However, the government has the obligation to reduce or suspend progress payments when a contractor is not meeting the material requirements of the contract, or performance of the contract is endangered by the contractor's failure to make progress. In the end, a contractor is entitled to "progress" payments only if he is making progress.

A "cure" notice does not hurt a contractor financially unless it is followed through with a termination for default. Since the ultimate objective is to have the contractor perform and deliver the equipment, reduction or suspension of progress payments will normally achieve this objective.

Mr. **Dingell**. If you give a cure notice, it says you have established a finding that the supplier is not in compliance with terms of delivery of items that meet the quality standards effected by the Air Force; is that not so?

General **Monahan**. Again, I don't know the technicalities associated with it. Obviously the Government may terminate the contract for default based upon evidence that——

Mr. **Dingell**. You two gentlemen are in charge of this big operation and you don't know the difference between withholding and a cure notice?

General **Monahan**. I think I know the difference, it is just I don't know the technical difference, and I would be happy to supply it for the record. A cure notice is a different situation. The cure notice is when you are anticipating, contemplating terminating the contract.

Mr. **Dingell**. That is right.

General **Monahan**. That is what we are not doing here. What we are doing is continuing on with the contract for very good reason, but we are withholding money from the contractor because he is not performing the way we want him to.

Mr. **Dingell**. Ms. Kingsbury, do you have your original notes now?

Ms. **Kingsbury**. Yes, sir, I have the notes.

Mr. **Dingell**. You have looked at them and refreshed your memory, have you?

Ms. **Kingsbury**. Yes, sir.

Mr. **Dingell**. The notes were made contemporaneously with the discussions?

Ms. **Kingsbury**. Yes, sir; I think I should make it clear for the record I did not personally write these notes. They were written by Linus Brackman——

Mr. **Dingell**. Is he here?

Ms. **Kingsbury** [continuing]. A GAO employee.

Yes, sir.

In the natural order and scheme of things at GAO these notes are reviewed and other people associated with preparation for this hearing have reviewed them recently and I have just briefly reviewed them and they are cognizant with what I remember of the occasion.

Mr. **Dingell**. What do you remember of the discussions that you had with General Yates at the time of the discussion, having read the notes?

Ms. **Kingsbury**. The record shows here, sir, that—I do recall the subject had come up about the refund, and the record indicates that General Yates said that he did not agree with the Secretary of the Air Force's request for a refund presumably because the costs had already been incurred; and that he did request it when he was ordered to do so.

Mr. **Dingell**. And what?

Ms. **Kingsbury**. And that he requested the refund when he was ordered to do so. That is what the notes say.

Mr. **Dingell**. General, what comments do you have on that?

General **Yates**. Sir, I would like to say again that when I said that I had not discussed the pulley puller with the GAO I was referring to Mr. Quicksall in the current investigation, and in fact that was in error. I did discuss that with Ms. Kingsbury and her people when they came out in February.

In fact, as she said, I did present a briefing on the pulley puller. It's my position that in fact the costs were incurred, they were incurred in accordance with this system that I described to you earlier. I was asked to obtain a refund from General Dynamics or to ask them if they would volunteer a refund, and they did, and took it.

Mr. **Dingell**. But you indicated you did not agree with that?

General **Yates**. I believe that is right, sir.

Mr. **Dingell**. It took rather longer to get that out than is really comfortable for me.

The gentleman from Oregon.

Mr. **Wyden**. Mr. Chairman, I think we have gone through the Westinghouse situation but I think that the Westinghouse situation with respect to the progress payments is not unlike the discussion we have had with Ms. Kingsbury, that there has been a failure to take affirmative action to protect the taxpayers.

I am just astounded, General Yates, that you can stand up there and go through, in all seriousness, this system and defend it as a reasonable way to go. You say, when I brought up the pulley puller, that we had made for like $69 and they said you could do it for $35, and the fact is that we do not see the affirmative action being taken to protect the taxpayers.

The fact that the chairman had to pull out this information literally with respect to the refund on the General Dynamics situation is I think the tragedy of this whole issue, and that is that there is no affirmative action. Only when the Air Force is literally brought under protest are any steps taken to protect the strategies of this country.

Thank you, Mr. Chairman.

Mr. **Dingell**. The time of the gentleman has expired. The gentleman from Minnesota, Mr. Sikorski.

Mr. **Sikorski**. I thank the chairman.

Mr. Wood, describe your contractual responsibilities to the Air Force providing support equipment in the most cost-effective manner.

Mr. **Wood**. Mr. Sikorski, it is your definition that I have responsibility, either fiduciary or otherwise, to furnish something in the most cost-effective manner. That is not true.

Mr. **Sikorski**. It is not?

Mr. **Wood**. I will, however, describe for you——

Mr. **Sikorski**. Under the F3365-7-A2-C-2034.

Mr. **Wood**. I haven't the foggiest idea of what you are talking about.

Mr. **Sikorski**. It is your F-16 contract. You were working for the Air Force on the other side of that a few years back. You might be familiar with that.

Mr. **Wood**. I am very familiar with the contract and I am very familiar with my working on the other side of the fence; yes, sir.

Mr. **Sikorski**. Let's go through it step by step. You are specifically obligated to recommend support equipment to maintain the aircraft; is that right?

Mr. **Wood**. That is a true statement.

Mr. **Sikorski**. Pardon me?

Mr. **Wood**. That is a true statement.

Mr. **Sikorski**. You recommended that the Air Force procure 24 items; is that correct?

Mr. **Wood**. That is correct.

Mr. **Sikorski**. Ranging from tools such as alignment pins and a modified simple hexagon wrench to boresight fixtures and vacuum/heat maintenance stands.

Mr. **Wood**. That is correct.

Mr. **Sikorski**. Most of the recommendations were submitted in January 1982?

Mr. **Wood**. I don't remember the time but that is probably accurate.

Mr. **Sikorski**. The Air Force planned to begin its own repair of the radar antenna in late 1984.

Mr. **Wood**. That is your assertion. I don't know, sir.

Mr. **Sikorski**. These are factual statements from the history of the acquisition contained in the GAO report.

Mr. **Wood**. But not factual statements made by me, sir.

Mr. **Sikorski**. I am not asking whether you made them or not. I am asking whether these are true statements.

Mr. **Wood**. I don't really know the time period.

Mr. **Sikorski**. You are in charge of contracts, aren't you?

Mr. **Wood**. I am corporate vice president for contracts.

Mr. **Sikorski**. And here you are talking about these problems under this particular contract.

Mr. **Wood**. As I said earlier—to the extent that I know them.

Mr. **Sikorski**. OK. You said you're not required under the contract that you received $10 million a year for since 1977, specifically to provide recommendations as to the support maintenance equipment and tools, you are not required to recommend the most cost-effective measures. Is that what you are saying?

Mr. **Wood**. I didn't say either of those. If I can show you, I will go to the board and lead you through it.

Mr. **Sikorski**. I made the statement that you are required under the contract to recommend the most cost-effective methods for tools, maintenance tools, and the rest. You said that was my statement of your fiduciary responsibility, not your view.

Mr. **Wood**. That is correct.

Mr. **Sikorski**. What is your view, which was my original question.

Mr. **Wood**. My view of my contractual responsibility is to deliver to the Air Force reliable equipment within the price that I negotiated in a timely fashion. That is my responsibility.

Mr. **Sikorski**. So you don't have a responsibility to recommend the most cost-effective means of procuring these tools?

Mr. **Wood**. We have a responsibility to, in conjunction with our vendors, identify the items to be furnished; also negotiate on behalf of the Government an equitable price or reasonable price for those items and ensure that they are delivered to spec, quality, and on time.

Mr. **Sikorski**. You are not responsible for recommending the most cost-effective methods of procurement?

Mr. **Wood**. If that is what you call what I just described, then that is what I do.

Mr. **Sikorski**. I think you specifically did not embrace the most cost-effective method. So you are saying you don't have a responsibility. Maybe we should get the contract up and take a look at it.

Mr. **Wood**. I will be very happy to do anything you would like.

Mr. SIKORSKI. OK. You said as you began and ended your statement today that there was a mountainous amount of paperwork and channels, regulations and procedures through which these kinds of tools are produced. Is that a fair statement?

Mr. WOOD. Yes.

Mr. SIKORSKI. And that that produces two things. I think if I can appreciate what you are saying, it produces a cost that is higher than the intrinsic value?

Mr. WOOD. Yes.

Mr. SIKORSKI. It also produces assurances to the people of the United States that these kinds of tools will be appropriate for the use, be durable, and the rest of it. They get assurances out of this process. Is that what you are saying?

Mr. WOOD. On balance you are correct.

Mr. SIKORSKI. OK. Now let me direct your attention to the paperwork requirements under the contract that produced these kinds of things and these kinds of costs. One was an unpriced modification, unpriced contract or undefinitized contract that was urgently needed. The GAO says there wasn't any urgency here, so that requirement, that procedure that you have embraced of producing the cost wasn't even met. Isn't that correct?

Mr. WOOD. You are making an assumption, sir, that I made the decision of urgency and the private sector does not make that decision.

Mr. SIKORSKI. I am saying that you came up and showed us a diagram and said that this great system produces the costs that people are complaining about, and produces assurances that what we are getting is good. And I am saying to you that that paperwork, that mountain of requirements, wasn't even met on the first key, the urgency business?

Mr. WOOD. I think I must correct one thing that you said, what I did say in my opening statement and maybe you have it in your hand, I am not sure.

Mr. SIKORSKI. It is right here.

Mr. WOOD. I said that I was not going to put a value judgment on whether that was necessary, that system, simply to try to convey to you that that is the contractual system that I was following.

Mr. SIKORSKI. That contractual system failed under the urgency, requirement, according to the GAO.

Second, the GAO report itself said with specific regard to you, General Dynamics, and I read on page 3, that "our review disclosed that the requirements determination process did not assure that only needed items ere authorized and that the authorized items were obtained in the most cost-effective manner. At several steps in the requirements process neither General Dynamics nor the Air Force followed proper procedures, nor did they comply with regulations intended to assure cost-effective acquisition of support equipment."

So that whole little wonder world of mountains and papers and channels that you have to go through that produced this cost wasn't even fulfilled in this particular instance?

Mr. WOOD. I can only say as far as General Dynamics is concerned, there is nothing in that process that we did not follow that we were contractually required to follow. We did obey to the letter of the law.

Mr. **SIKORSKI**. The GAO says while General Dynamics officials believe they complied with contract requirements—and I quote GAO—"they were unable to document that the assessments required were conducted prior to recommendation that the item be required as contractor-furnished equipment." That is on page 3.

Mr. **WOOD**. We can now correct that. We have gone back and researched our records and we did find that our committee did review those, it was done by some eight people and we can submit that to you.

Mr. **SIKORSKI**. We would appreciate that.

Further, in buying into this paperwork and process and regulation scheme that produce this great cost and assurances to the taxpayers that we are not getting taken, the GAO says on page 2, "Although regulations require prices to be definitized within 180 days, price negotiations with General Dynamics for these items took about 13 to 20 months to complete." That process wasn't fulfilled in this instance.

Mr. **WOOD**. I think, sir, if you check the record you will find that the highest percentage of the undefinitized backlog is in excess of 180 days, and not just with General Dynamics. There are a multitude of reasons for that, which I would be delighted to share with you off camera sometime, if you like.

Mr. **DINGELL**. Would the gentleman yield?

Mr. **SIKORSKI**. Certainly, Mr. Chairman.

Mr. **DINGELL**. I would like to ask these questions of both General Yates and his associate. Gentlemen, who made the decision that this contract should be handled on an urgent basis and why was that decision made?

General **MONAHAN**. The reason for urgency associated with this, Mr. Chairman, is what I mentioned when I spoke earlier. At that time we had aircraft out in the field already for 2 years. We did not yet then have a depot. We were hoping that we would have one by sometime in 1983. This particular action that came up, where we had to procure these tools, moved that activation date out about 2 years on us.

We had to get—we had to limit that schedule slip associated with the procurement of these tools. We were paying Westinghouse $1.6 million a year to run a depot repair facility. If we did not—well, every year, of course, then that the activation of our own depot slips requires an additional $1.6 million and we have to pay out to him just like rent, you don't get return on your equity.

So it was incumbent upon us to do this as quickly as we possibly could. But I would submit that in this case any auditor, any contracting officer that looked at it very, very carefully, the fact of it was that undefinitized action that took in excess of 180 days did not affect the price of this particular action.

Mr. **DINGELL**. Why do you make that statement? That statement seems to be somewhat at variance with every other statement that we have received from the General Accounting Office.

General **MONAHAN**. General Yates took you through the specifics of what we paid for in this particular instance. We had to pay for the engineering, the drawings, et cetera, et cetera, et cetera, et cetera. That is going to happen whether we had definitized the contract early on or not. As a matter of fact, Mr. Chairman, as I believe I said, and perhaps didn't say it clearly enough, if we had attempted to have a definitized fully priced contract in late 1982, we would have run high risk of negotiating a very high price for that contract which results—and there is no way to reduce that--results in excessive profits going to the contractors.

If we detect excessive profits, there are procedures to use after the fact that perhaps you can get some of it back. But the not-to-exceed, unpriced or undefinitized order that we used in this case, we are able to negotiate down. We don't establish the final firm price when we don't know enough about the situation or the tools, and neither does the contractor, to be able to negotiate a good, fair price. If we had definitized the contract at this particular period of time, we would have established a price from which neither of us could possibly recover later.

In this way at least we are able to reduce the price. And as you can see, we ultimately came up with a contract there for those eight items displayed before you, that despite the fact we got a proposal of $499,000 we ultimately reduced the price down to $249,000.

Mr. **Dingell**. The regulations require you to definitize—I don't like the use of that word because it is bad English but that seems to be the regular practice here in government—require you to definitize those contracts within 180 days.

General **Monahan**. Yes, 180 days is our standard. Let me tell you why we do that.

Mr. **Dingell**. This is supposed to be done within 180 days but you seem to find that most frequently you do not do this in 180 days or at least here in the instance before us you did not do it in 180 days.

General **Monahan**. Yes.

Mr. **Dingell**. I wonder, what is the point of having a requirement on the books which cannot be or probably, according to your testimony, should not be carried forward?

General **Monahan**. I think the 180-day standard is a very good standard. The reason for it is that it ensures we employ discipline in getting these contracts fully definitized. That is the major reason for establishing a 180-day standard.

Mr. **Dingell**. When was this contract then definitized?

General **Monahan**. It was finally in March 1984.

Mr. **Dingell**. How long a period of time? Which was a period of how long after it was first let out?

General **Monahan**. From September 1982 to March 1984, and I think that is 18 months, if I calculate correctly.

Mr. **Dingell**. 2½ years approximately.

General **Monahan**. Yes.

General **Yates**. One and a half.

Mr. **Sikorski**. Mr. Chairman, if I may.

Mr. **Dingell**. The gentleman from Minnesota.

Mr. **Sikorski**. General Monahan, you showed in your chart that you began the process in September 1982. According to the GAO documents and information we got from General Dynamics, they made the recommendation in this process, it began in January of

1982, in fact some of it was recommended in 1981. So that process began a lot further along in its process than it appeared.

General MONAHAN. In September 1982 is when we awarded the not-to-exceed contract to General Dynamics. There were events that preceded that.

Mr. SIKORSKI. Yes, and as I understand these contracts, when they made the recommendations they started on the process of incurring costs.

General MONAHAN. No; they do not start that until we sign a contract with the contractors.

Mr. SIKORSKI. Back in September. You also say now the 180 days is a good idea. Back when you were standing over here, you said the time deadlines are bad negotiating.

General MONAHAN. No, no, let me—I agree that the 180 days is a very good idea because it imposes discipline upon us and the contractors to get the work done.

What is bad—and this is an excellent example of what happened here—is to negotiate a contract where the contractor knows you have to meet a deadline that he doesn't. So guess where all the negotiating leverage is. It is on the side of the contractor. So we don't do that.

Mr. SIKORSKI. My suggestion is you buy the drawings and move them yourself and——

Mr. WYDEN. Would the gentleman yield?

Mr. SIKORSKI. Certainly.

General MONAHAN. What I would like to further explain is this one point, in this case the reason we didn't make the 180 days is because we did not agree with the proposal that had been submitted on the part of General Dynamics. We went back in a formal way and asked them to repropose. So you more or less start the clock all over again.

Mr. WYDEN. I appreciate——

Mr. DINGELL. Wasn't that after the Senate had gotten on it?

General MONAHAN. It was not after the Senate had done that. This was in April 1983. I forget the Senate schedule but I don't believe that was the case.

Mr. SIKORSKI. Mr. Chairman, I have just a couple questions for Mr. Wood regarding his previous employment.

You are currently a vice president for General Dynamics?

Mr. WOOD. That is correct.

Mr. SIKORSKI. And your salary is what?

Mr. WOOD. It is for the record available.

Mr. SIKORSKI. Do you want to give it for the record?

Mr. WOOD. I would prefer not to but if you insist——

Mr. SIKORSKI. I would like to hear it.

Mr. WOOD. I make about $130,000 a year.

Mr. SIKORSKI. And before this you were working for the Government; is that correct?

Mr. WOOD. Can we establish what this is before August 1, 1978?

Mr. SIKORSKI. Before you worked for General Dynamics.

Mr. WOOD. Before August 1, 1978, I was international business adviser for the F-16 program and I worked for the Department of Defense. I left there August 1, 1978.

Mr. **Sikorski**. As I understand the flow chart on the F-16-F-100 chronology, you began as the LWF lightweight fighter business manager for the U.S. Air Force in 1972; is that correct?

Mr. **Wood**. That is correct, but I didn't begin with the Air Force then.

Mr. **Sikorski**. OK.

Mr. **Wood**. That is when I became a part of the Prototype Program Office.

Mr. **Sikorski**. You were with the Air Force prior to that?

Mr. **Wood**. Yes, I was.

Mr. **Sikorski**. In——

Mr. **Wood**. I first went to work for the Air Force in 1952.

Mr. **Sikorski**. So from 1952 to 1978 you worked for the Air Force?

Mr. **Wood**. No; I worked for the Air Force 1952 until—I am guessing but I think about 1954 when I went to work in the private sector and came back in 1961.

Mr. **Sikorski**. OK. From 1961 then through 1978—72 you worked for the Air Force, in 1972 you became the lightweight fighter business manager, which gives you direct program and contract management responsibility and authority in participation in all business management actions of the program office, used directly or by delegation. Then in 1974 you became the U.S. Air Force ACF, which is the air combat fighter source selection evaluation board for contracts.

Mr. **Wood**. I am sorry, you are completely off base on what you just said.

Mr. **Sikorski**. You are Mr. F.S. Wood, are you not?

Mr. **Wood**. Yes, I am, but I don't know what you are reading from. I am only saying what you are stating is inaccurate.

Mr. **Sikorski**. From 1974 to 1975 were you on the source selection evaluation board in contracts?

Mr. **Wood**. From 1974 to 1975, I think—and I am guessing—I think I was the chief of procurement in the ACF Program office and I think what you are looking at—and I say "I think" what you are looking at—is probably a flow diagram of some events that occurred during that period of time, but there was no such title as source selection evaluation officer.

Mr. **Sikorski**. During that time you were the program—you were in the program office, were you the deputy director then?

Mr. **Wood**. No, I was not the deputy director. I ran the procurement operation and maybe the title was deputy director, I am not really sure.

Mr. **Sikorski**. The F-16 Program was run through your office; is that correct?

Mr. **Wood**. Right, along with the advanced medium S/TOL transports, along with the quiet airplane, along with a low radar cross-section——

Mr. **Sikorski**. I am reading from the Defense Department F-16-F-100 flow chart chronology, and you were the F-16 SPO system program office business manager as well.

Mr. **Wood**. I had that title at one time, yes.

Mr. **Sikorski**. And then you had that title until what date?

Mr. **Wood**. I don't remember.

Mr. Sikorski. So you left Government with that title, did you?

Mr. Wood. No; I left Government as the international business adviser for that F-16, Department of Defense, August 1, 1978.

Mr. Sikorski. When did you take that job, get that title?

Mr. Wood. I think I got the title maybe a year or two before I left, but that is guessing on my part.

Mr. Sikorski. Did you ever recuse or disqualify yourself from working on the F-16 project?

Mr. Wood. Yes, I did.

Mr. Sikorski. Did it involve General Dynamics?

Mr. Wood. Yes, it did.

Mr. Sikorski. Because of your future employment with General Dynamics?

Mr. Wood. Because I had been contracted for employment. I was contacted on May 7, 1978, and on May 8, I told everybody from the Secretary of the Air Force down to Jim Abrahamson, who was program director for the F-16.

Mr. Sikorski. Have you ever appeared before DOD concerning the F-16 project since?

Mr. Wood. Appeared before—I have been called by DOD for some of my corporate memory. I have never negotiated on behalf of General Dynamics anything associated with the F-16 or the YC-14 or 15 subsequent to that date.

Mr. Sikorski. The people at SPO who overruled the AFPRO, who raised excess pricing concerns, worked for you during the time you were at the SPO?

Mr. Wood. That is not true.

Mr. Sikorski. I am asking you a question, I am not making a statement.

Mr. Wood. That is not true.

Mr. Sikorski. Those people in SPO who overruled the AFPRO were not in your office when you were deputy director?

Mr. Wood. I don't know who those people were.

Mr. Sikorski. How do you know it is untrue then?

Mr. Wood. Well, the AFPRO did not work for me and that is what I understood to be your question.

Mr. Sikorski. The AFPRO was overruled, the AFPRO said and you heard the statement earlier, page 7 of the GAO report, said these things shouldn't be costing thousands of dollars. In fact, they should be in the $2 to $150 category, the other items in the $13,000 to $28,000 range should be $200 to $500 range. He was overruled the people at the——

Mr. Wood. What is the timeframe, please, Mr. Sikorski?

Mr. Sikorski. This is in June 1983, April 1983, and June 1983.

Mr. Wood. I left the Air Force 1 August 1978, sir.

Mr. Sikorski. I understand that. I am asking you if the people in the SPO who overruled the AFPRO on this matter dealing with General Dynamics were in the office when you were deputy director of that office.

Mr. Wood. I can't answer that because I don't know who those people were.

Mr. Sikorski. The Air Force brought Mr. Tully here today. He took your job over there, didn't he?

Mr. Wood. No; Mr. Tully did not replace me.

Mr. Sikorski. He is in the deputy director position.

Mr. Wood. He may have today sir, but he did not replace me.

Mr. Sikorski. Was he in the program office when you were there?

Mr. Wood. He was part of the program office but did not work for me.

Mr. Sikorski. You worked with him at the time?

Mr. Wood. Yes; I did.

Mr. Sikorski. Maybe what we need from the Department of Defense and from you, Mr. Wood, is a clear designation of who was there back in 1978 and who was there back during the time that the AFPRO was overruled with respect to these excessive pricing issues.

Mr. Wood. Very fine. I have no problem telling you about myself. I have no problem with that at all.

Mr. Sikorski. We will get back to that in the next round, OK?

Mr. Wood. Wonderful.

Mr. Sikorski. Thank you, Mr. Chairman.

Mr. Dingell. The Chair recognizes the gentleman from Texas, Mr. Bryant.

Mr. Bryant. Thank you, Mr. Chairman.

General Monahan, I would like to ask, first of all, when were the charts prepared that you showed us this morning?

General Monahan. I prepared this over this past weekend.

Mr. Bryant. Pardon me?

General Monahan. I prepared them over this past weekend. Saturday night, as a matter of fact.

Mr. Bryant. Did you prepare them in response to the General Accounting Office's report?

General Monahan. Yes.

Mr. Bryant. Your first statement to this committee was you were sorry you couldn't respond in detail because you had not had an opportunity to study the General Accounting Office report in detail.

Isn't that what you said?

General Monahan. That is exactly what I said.

Mr. Bryant. Was that statement wrong or was it an exaggeration or do you want to amend it in some fashion?

General Monahan. No, Mr. Bryant. We have not been able to—I said the Department of Defense and Air Force had not had the opportunity—that is more than just me—to study this report in detail.

So obviously the Air Force cannot provide an Air Force response. I cannot unilaterally myself provide an entire Air Force position.

Mr. Bryant. Why not?

General Monahan. I have had the opportunity over about 3 days to read the report and read it probably four or five times.

Mr. Bryant. That is not exactly the statement you made when you first sat down there, I think, which leads me to make an observation. I think we could all work together a whole lot better with just a little more straightforward candor.

The fact is the committee sent you this report, I think the chairman said, on Wednesday or Thursday. The information fact is I have the report in my hand and if you leave the exhibits out of it, which don't require reading, or pictures of things you are well familiar with, this report is only 12 pages long.

How could you come to this committee and say that the Air Force of the United States of America didn't have the chance to look at this report in detail since last Wednesday when it is only 12 pages long?

General **Monahan**. I have not had an opportunity to look at it in sufficient detail, so we could prepare a firm U.S. Air Force position in response to the report.

Mr. **Bryant**. I think that speaks for itself.

Let me ask you a question. Do you believe the procurement system we follow in this Government buying weapons is working?

General **Monahan**. Yes, very definitely.

Mr. **Bryant**. Do you disagree with the statements that were made before this subcommittee several months ago by, I think, the inspector general from the Department of Defense, that fully one-third of the procurement budget is wasted?

General **Monahan**. I don't recall those remarks.

Mr. **Bryant**. Well, just take it from me he said it. Would you agree with that if somebody said it?

General **Monahan**. No, I would not.

Mr. **Bryant**. Do you think things are working just fine the way they are?

General **Monahan**. There is always room to do things in better fashion, no question about it. Believe me, the Department of Defense and the Air Force is open for good suggestions, good ideas. We will take all the help we can get in improving any procedure we have whether that has to do with procurement or anything else.

So we are open to good ideas and good suggestions. We put in an awful lot of time working on it to make things better.

Mr. **Bryant**. One good idea might be to stop using these urgent no-price contracts that you used and that we have discussed in this hearing.GAO testified that one of the urgent items, that is the adapter assembly, one of those items you have acquired without ever negotiating a price on, it is now missing from the inventory of the Air Force and went unnoticed for more than a year until the GAO tried to find it, not the Air Force.

We understand now that a 10-man Defense Department team has been dispatched by Secretary Weinberger to find this item as of September 18.

Now, I would like to ask you, is that your idea of an urgently needed item?

Mr. **Dingell**. Will the gentleman yield?

Which item is that that the Defense Department is dealing with?

Mr. **Bryant**. According to our briefing papers, the assembly, the adapter assembly.

Mr. **Dingell**. The Chair thanks the gentleman.

Is that the item the Defense Department could not find?

Mr. **Bryant**. That is what we have been told.

Mr. **Dingell**. Maybe General Monahan or General Yates can tell us what the Defense Department is using in lieu of this item which they could not find. What are you using to carry out the functions of that item?

General MONAHAN. I expect, Mr. Chairman, you will find that this particular—you will probably find this particular item was needed to ensure the total depot capability existed at San Antonio for our aerial refueling system.

The fact it has not been used yet is good in one sense because it says we have not had to do those kinds of repairs yet, but we clearly will have to over the 30-year cycle in the period of time in which we maintain these weapons.

Mr. DINGELL. Let's go over this adapter assembly.

This was procured on an urgent basis, was it not?

General MONAHAN. I don't know the extent of urgency associated with that procurement.

Mr. DINGELL. The reason you use the procurement process that you use was because there was a feeling that it was urgent, urgent that the Air Force have it; is that not right?

General MONAHAN. That was one of the reasons, not the only one.

Mr. DINGELL. That was one of the reasons?

General MONAHAN. That was one of the reasons, Mr. Chairman.

Mr. DINGELL. So the Air Force had a feeling this device was urgent.

General MONAHAN. Made the feeling that——

Mr. DINGELL. And I am asking what is being used in lieu of this urgently required device.

General MONAHAN. I would have to tell you I don't know.

Mr. DINGELL. Pardon?

General MONAHAN. I don't know.

Mr. DINGELL. Well, it is lost?

General MONAHAN. I am told they are not able to find it. Yes, I would have to say it is lost. That is correct.

Mr. DINGELL. What I am trying to find out is you have lost it, it was urgently required, you used provisions of law and contracting authority which was suitable for urgently required equipment, and I am asking you now what are you using in place of this urgently required equipment to maintain the radar array on this fighter aircraft?

General MONAHAN. First of all, I don't know the answer to your question, Mr. Chairman. This is not an item used with the radars. It is used in air refueling. It has nothing to do with these tools up here.

Mr. DINGELL. It was one of the General Dynamics items for which—and its function it says here is "to accomplish depot dielectric strength tests applicable to the electrical connector and connector ease of inflight receptical IFR and diamond test applicability to the electrical connector of the IFR."

Sounds very important to me.

General MONAHAN. It is very important, Mr. Chairman.

Mr. DINGELL. Well, having established it is very important, what are you using in lieu of this one-of-a-kind item?

General MONAHAN. I have told you I don't know, Mr. Chairman. That is not in my area of expertise, but I will be very happy to find out and supply it for the record.

[The information follows:]

Question. What is the AF using in lieu of the inflight refueling (IFR) adapter assembly (electrical cable harness-SERD 46167) to perform depot level maintenance on the F-16 aircraft refueling receptacle?

Answer. No item is being used. As of this date, no depot level repairs have been necessary. The Air Force is presently constructing a new test harness using the drawings and specifications previously purchased with the SERD documentation package.

Mr. DINGELL. Thank you.

I thank the gentleman from Texas for yielding.

Mr. BRYANT. I wonder if Mr. Yates can answer those questions that the Chairman just asked—General Yates, excuse me.

General YATES. I have to also respond, sir, that I don't know what the Air Force is using now in place of that device to repair the inflight refueling receptacle at the depot.

Mr. BRYANT. As far as you know, you agree that this item is lost?

General YATES. Yes, I agree this item is lost.

Mr. BRYANT. And you do agree that you procured the item on the basis that it was urgently needed?

General YATES. It was procured on the same urgent basis, yes.

Mr. BRYANT. Let me ask about another one, General Monahan. You procurred on an urgently needed basis the vacuum heat maintenance test stand. This is from page 16 of the GAO report in case you need to look at it.

General Dynamics originally proposed a price of $302,106. As of July 1985, the GAO found that this item was in storage at Ogden because the instructions on how to use it still had not been received.

Under those circumstnaces, how did you justify including it as an urgently needed item?

General MONAHAN. It was one of the items needed to get us to the total depot repair capability such that we can get out from under using the contractor and depending on him for it. The technical orders delivered were not sufficient. I agree with that. We couldn't use the item then because of that particular deficiency.

Mr. BRYANT. How long have you had it and been unable to use it? How long has it been honored?

General MONAHAN. It was part of the order in September 1982.

Mr. BRYANT. September 1982, Mr.——

General MONAHAN. I believe the delivery period was probably in 1984.

Mr. BRYANT. Is this a General Dynamics product, I believe?

General MONAHAN. It is a Westinghouse product.

Mr. DINGELL. Would the gentleman yield to the Chair again?

Mr. BRYANT. Yes.

Mr. DINGELL. What are you using in place of this urgently required item which has a function, and I quote now here, of doing this, "reseals the F-16 antenna array by covering the antenna array pod for depot repair over all of the antenna." What is the Air Force using in lieu of this?

General MONAHAN. We do not have the capability to do it yet. We now have to rely upon the contractor to do that repair.

Mr. DINGELL. This was procured again under the provision of urgent acquisition?

General MONAHAN. Yes; that was one of the things that led us to the "undefinitized" type contract.

Mr. **Dingell**. And in consequence of which you did not "definitize" your contract under the arrangements as required by regulations for 180 days, is that correct?

General **Monahan**. That is right; and the reason we did not was because the proposal we got from the contractor was excessive.

Mr. **Dingell**. You have paid $137,000, have you not, for this item?

General **Monahan**. I don't really know. General Yates can probably look up the specific value of that.

Mr. **Dingell**. General Dynamics paid $137,000, the Air Force paid $163,843, and what I am trying to figure out is have you "definitized" the price on this?

General **Monahan**. Yes.

Mr. **Dingell**. How could you "definitize" the price and justify the urgency of this when you haven't yet used it because they haven't told you how?

General **Monahan**. I don't quite get the gist of how I could not "definitize"—I knew what the item was and what it would take to introduce it——

Mr. **Dingell**. Do you know that this item will work?

General **Monahan**. Yes. It has been tested and the item will work.

Mr. **Wyden**. The pulley puller was tested, too, wasn't it?

General **Monahan**. Yes; but when delivered it had an improper head on the bolt.

Mr. **Wyden**. It didn't work, in other words?

General **Monahan**. Mr. Wyden, you bring up a very good point here. That item would have worked and worked very, very fine if you tried to get off the antenna pulley after the Azimuth evaluation motors had been removed in the antenna, and that is probably the way it was tested.

This points out the importance of having properly tested tools even though those tools would appear to be noncomplex and very simple.

Mr. **Dingell**. Have you ever inquired whether Westinghouse uses this?

General **Monahan**. Yes.

Mr. **Dingell**. Does Westinghouse use it?

General **Monahan**. Yes.

Mr. **Dingell**. GAO says they do not.

General **Monahan**. I think the GAO report says that they do not have one at their repair facility.

Mr. **Dingell**. No. GAO observed, and I will quote, "Westinghouse repair center does not use this for antenna repair."

General **Monahan**. That is right. They go to their manufacturing facilities where they have the equivalent tool.

I checked that with Westinghouse. We knew it was required before we bought it.

Mr. **Wyden**. Would the gentleman yield?

All this stuff was ordered "urgently needed" because you were beginning your own depot maintenance system.

When did this begin and when did you start repairing your own radar?

General **MONAHAN**. We did it a few months ago, we have been through the first five prototype systems, as I recall. I believe we are doing 20 more this quarter.

If we have waited and had been able to "definitize" there in March of 1984, if it had taken us that long, as it ultimately did, we wouldn't even have that equipment onboard yet.

We would be beholden to the contractor for at least another 6 months, probably longer for depot repair. That is the bottom line of how it finaly worked out.

Mr. **WYDEN**. I thank the gentleman for yielding.

Mr. **DINGELL**. The gentleman from Texas.

Mr. **BRYANT**. I think it is valuable to observe that, again, the Air Force "undefinitized" contract actions, as you put it, or unpriced orders had gone from $5.9 billion in September 30, 1983, to $10.9 billion as of September 30, 1984, about a 100 percent increase in 1 year there.

Isn't that a curiosity?

Do you think there is a legitimate explanation for that?

Is there that much urgency?

General **MONAHAN**. I am sure there is an explanation. I don't know the complete facts associated with it.

Mr. **BRYANT**. How many layers of authority are there between you and the Secretary of the Air Force?

General **MONAHAN**. Any time that I need access to the Secretary of the Air Force, it is immediately available to me.

Mr. **BRYANT**. Did you happen to run by his office with this GAO report?

General **MONAHAN**. No.

Mr. **BRYANT**. Why not?

General **MONAHAN**. I didn't see any reason to do that.

Mr. **BRYANT**. How did you get it?

General **MONAHAN**. I don't really know. It showed up in my office.

Mr. **BRYANT**. We sent it to the Secretary of Defense.

General **MONAHAN**. I think it got to me about the same time it got the Secretary of Defense.

Mr. **BRYANT**. From where? We sent it to you.

General **MONAHAN**. I don't know.

Mr. **BRYANT**. You don't know who did?

General **MONAHAN**. I don't know.

Mr. **BRYANT**. Do you have assistants here today? Who puts things on your desk?

General **MONAHAN**. A number of people do that; but I don't know who gave it to me.

Mr. **BRYANT**. I think it is certain we will read something in the paper that says an Air Force spokesman clarified what General Monahan or General Yates said to make this clear.

You have had plenty of time to develop your response, and I would like to get you guys in a position where your response can be counted on as the final answer of the Air Force.

Who do we have to communicate with to get the Air Force response?

General **MONAHAN**. The Air Force will be happy to provide a response.

It has been my experience—I have been involved with a number of GAO reports—that we review drafts of the report before the final report is written. We talk to people in the GAO about it, we provide formal written comments.

That is our normal mode of doing business; so when we get a General Accounting Office report, in many cases we can take and look at it, and turn around an Air Force position on it very quickly. But here is one where we didn't have the draft so we didn't know what to expect.

Mr. **Bryant**. You had the final copy, 12 pages. My kids write research papers in elementary school that are that long. I don't understand why it is so difficult for you.

You say you have access to the Secretary of the Air Force, if I ask him questions about these things, he is going to ask you isn't he?

General **Monahan**. I imagine me as well as many other people, Mr. Bryant.

Mr. **Bryant**. The point is you guys keep shifting your ground and we can't find out who is responsible.

General **Monahan**. May I expand on a good point you made earlier?

You said when are we going to start working together to make the defense acquisition process work well. I think there are excellent examples of how Congress and DOD have worked together to make major savings in the defense acquisition process.

One is the alternate fighter competition of 2 years ago. We saved in acquisition, between the Congress and the Department of Defense, somewhere around $3.5 billion.

Another is the multiyear procurement initially of the F-16, a program worked between the Congress and between the Department of Defense, where we saved $257 million.

The technical modernization program of American industry funded in part by the Air Force—by the American people—has saved on the F-16 alone, we think, over $2 billion.

I think this shows that there have been excellent examples in the past of cooperation between the Department of Defense and the Congress and the contractors involved, in ways to get more defense acquisition for the money. And I think by and large, if you go back and look at the track record of many of our major programs you will find an excellent story of cooperation that has resulted in more defense for the taxpayer.

Mr. **Dingell**. Would the gentleman yield?

Mr. **Bryant**. Yes.

Mr. **Dingell**. How many of these F-16 radars have been repaired by the Air Force at its facility?

General **Monahan**. I believe five, Mr. Chairman.

Mr. **Dingell**. Commencing on what date?

General **Monahan**. It was in the last quarter—I believe it was July, Mr. Chairman. I really don't know for sure.

Mr. **Dingell**. Well——

General **Monahan**. We are in a transition period right now where we are transferring from the contractor doing the depot level repair to the Air Force.

Mr. **Wyden**. Were those actually repairs, or are these prototypes?

General **Monahan**. Prototype repairs, yes, sir.

Mr. **Dingell**. But not actually repairs?

General **Monahan**. Right. I don't know the level of deficiency that had to be corrected.

Mr. **Dingell**. What is a prototype?

General **Monahan**. I don't know if we induce failures and try to fix them or——

Mr. **Dingell**. You induce failures?

General **Monahan**. Simulated failures.

Mr. **Dingell**. What is a prototype repair?

Is it, in fact, a repair; is it a simulated failure; is it an induced failure; what is a prototype repair?

General **Monahan**. We have people here from the Ogden Air Logistics Center who could answer that question.

Mr. **Dingell**. Maybe you could help us first, and we will try to get around to the others at the proper time.

What is a prototype repair?

General **Monahan**. Mr. Dingell, I don't know. I cannot give you a good description of a prototype repair.

Mr. **Dingell**. We will hear from witnesses, but this was all on a contract which was urgently let back in 1982?

General **Monahan**. That is true, Mr. Chairman.

As I said if we had waited to "definitize" that contract, when we finally were able to do so, we wouldn't have had the equipment by now.

Mr. **Dingell**. I am not sure you are not in a startingly difficult position from that about which you explain. I observe on the item we have been discussing you have not yet received the instructions as to how to use it.

General **Monahan**. We do have the instructions, the technical orders.

Mr. **Dingell**. When did they come in?

General **Yates**. Mr. Chairman, there are two versions of the radar. For the earlier version of the radar, it is my understanding that we received the technical orders in May.

For the late version of the radar we received the techncial orders this month.

Mr. **Dingell**. GAO says with regard to the vaccuum/heat maintenance stand, that the Westinghouse repair center does not use this item. It also says that it was stored unused at Ogden, because the technical order on how to use the stand had not yet been received.

When had the technical order, or the use of this stand, been received?

General **Yates**. Sir, I say again, we received the technical orders for the latest version of the radar this month, the month of September.

Mr. **Dingell**. During September you received it?

General **Yates**. Yes, sir.

Mr. **Dingell**. Now you paid, however, General Dynamics, $163,000 for this item. When did you do that?

That was in March, was it not?

General **Yates**. That contract was "definitized" in March 1984, sir.

Mr. **Dingell**. 1984, you paid them?

General **Yates**. That was when the contract was "definitized." The item was delivered in August 1984, which was when we would have paid them.

Mr. **Dingell**. How can you pay somebody before they tell you how to use it?

Isn't that a part of the contract?

General **Yates**. Sir, the testing process that I described earlier does that. We had gone through the testing process.

Mr. **Dingell**. But you didn't have the technical instructions. The technical order on how to use the stand had not been received?

General **Yates**. Correct.

Mr. **Dingell**. And it has not been used for that reason?

General **Yates**. They were delivered and they were deficient and returned to the contractor for replacement.

Mr. **Dingell**. Has the contractor been paid for this item?

General **Yates**. He has now. I assume he has since we took delivery of the technical orders this month. I don't know that for a fact.

Mr. **Dingell**. Are those technical orders adequate?

General **Yates**. I can't answer that. I don't know.

Mr. **Dingell**. You have been making progress payments on this item; have you not?

General **Yates**. I have to say that I am not sure, I am not sure about whether or not we made progress payments on these technical orders.

Mr. **Dingell**. Isn't it the regular order of things to make progress payments?

General **Yates**. Yes, sir, absolutely.

Mr. **Dingell**. So the subcommittee must presume that progress payments have been made even though they haven't told you how to use this thing, and it has been stored for a number of months unused because you haven't gotten the technical orders on how the device is to be used; is that right?

General **Yates**. I think that sounds logical to me.

Mr. **Dingell**. How do you justify that?

General **Yates**. Mr. Chairman, what we did was we got the material, and it was to arrive at the time the technical orders were.

Mr. **Dingell**. The technical orders didn't come?

General **Yates**. Sir, the technical orders did come.

Mr. **Dingell**. But they were deficient?

General **Yates**. And they were deficient.

Mr. **Dingell**. So, you went ahead and made progress payments anyhow?

General **Yates**. But, sir, as far as the machinery was concerned, the oven, it was delivered at about the same time as the technical orders were originally scheduled. There wasn't anything that we could determine wrong with it so we kept it. When the technical orders came, they were deficient so we returned them to the contractor.

Mr. **Dingell**. How do you know it worked if you didn't have the technical orders, and two, what good is it without the techncial orders?

General **Yates**. Well, let me answer the last one first because it is the easiest.

It isn't any good without the technical orders.

Mr. DINGELL. They could have delivered you a pile of scrap iron that would be just about as useful?

General YATES. That is right.

Mr. DINGELL. So now you have this splendid piece of equipment that you don't know how to use.

How do you know this splendid piece of equipment works?

You don't have the technical orders?

General YATES. You don't need the technical orders to determine if it works.

Mr. DINGELL. You don't?

General YATES. No, sir. You need the technical orders so that the technician at the depot can utilize the equipment in repair of radar sets, but you don't need the technical order, per se, to determine if it works.

You can apply power and determine the functioning of the machine without the entire set of techncial orders.

Mr. DINGELL. You see whether lights go on, and dials move, and it makes noises, and it uses electric power, but you can't tell whether it does what it is supposed to do unless you have the technical order, can you?

General YATES. I would say this, Mr. Chairman. I would say you cannot determine if it totally functions without repairing a radar set, that is true, but I don't agree with your statement that you have to have the technical orders to determine the function.

Mr. DINGELL. How do you know how to work the thing if you don't have the technical orders?

General YATES. There are two different things. The first question you are asking is, can we accept a piece of equipment without technical orders. The answer is, yes; and that is called acceptance test procedure and you run the equipment through a test procedure.

Can we utilize it for its intended functions in the depot without the technical orders; the answer to that is, no.

Mr. DINGELL. Here is a machine at a price negotiated in March 1984, it sits unused until July 1985 because you didn't have a technical order.

Wasn't anybody curious about where the technical order was?

General YATES. Oh, yes, sir.

Mr. DINGELL. You had procured this thing under urgent procurement procedures. I must assume that this was sufficiently urgent that you would have insisted that you got the technical order with a resonable level of speed. You did not.

A year and almost a half went by before you got the technical order. You had paid for it but you hadn't gotten the technical order.

General YATES. We did run, there is a compatibility test procedure. We did run acceptance test procedures.

Mr. DINGELL. What does that tell you?

General YATES. That tells you that the machine is functioning as designed.

Mr. DINGELL. Does it tell you whether it will carry out its function of receiving the F-16 antenna array?

General YATES. Yes, sir.

Mr. DINGELL. Without a technical order?

General **Yates**. Yes, sir.

Mr. **Dingell**. You folks in the Air Force are remarkably trusting folk.

You are good hearted beyond telling and I believe you should perhaps qualify for cannonization or membership in a religious order, but this doesn't qualify you necessarily to be buying equipment for the taxpayers.

Mr. **Wyden**. Gentlemen, the fact is you are not fixing airplanes. General Dynamics is still fixing airplanes so this whole urgent need business is really just a charade. You are not fixing airplanes.

Do you have anything that would indicate what I am saying is wrong?

General **Monahan**. Mr. Wyden, I would like to be able to provide you with some data if I may. In establishing our depot capability for the F-16 there are 623 items total which we will be repairing at the depot. As of the present time we have capability to do 511 of those out of 623.

Mr. **Wyden**. But you will can't do radar antennas?

General **Monahan**. There are another 81 projected within 12 months; and 1 year from now we will have achieved just about complete capability.

We have capability for the radar at the present time, we are doing prototype testing on it.

Mr. **Wyden**. But the fact is today you can't fix airplanes, General Dynamics is fixing airplanes, and this is just a charade, the language about "urgent need" is a big charade and the taxpayers are being taken.

You still can't fix any airplanes, you just told me that. I appreciate the gentleman yielding.

Mr. **Bryant**. General Monahan, you told the subcommittee staff that you reviewed the proposal, I think in depth, that included two cases of defective pricing by General Dynamics on products they were making for you. There are boresight fixtures, one for radar, and one for something called an INU.

I think the question is you partially don't recall the discussion that you have had with the subcommittee staff, and I won't press the issue with you, but the fact of the matter is that there were two cases of defective pricing on the part of General Dynamics, and that partially you or your staff missed what looks suspiciously close to fraud.

Can you explain how you missed something like that?

General **Monahan**. I don't know the details of this particular item, Mr. Bryant. Let me just tell you, in doing the procurement of our hardware, we audit and we review what the contractor tells us, but we have to rely upon the data that he has, the books that he has, et cetera, so that is our level of being able to detect something such as defective pricing.

Mr. **Bryant**. I still don't understand how you missed it.

General **Yates**. Well, sir, this is my understanding of the facts behind that, OK?

At the time of the negotiation with the Air Force in February 1984, to support that negotiation General Dynamics asked from their agents who procure the material, the latest purchase request that they had from their vendors from whom they bought this material, and that went to negotiation.

That is owed the Air Force as a part of what the contractor has to provide and General Dynamics provided it.

This part I can't tell you about factually, but let me surmise so we can understand it.

What can happen after they provide one of those to the negotiating team is that there is another purchase request in the system, in other words, a later one than the one they provided, which provides a basis for the negotiation, and it comes in later, so between November, when they got the information, and February, when they sat down to negotiate, I am guessing that another purchase request came in to General Dynamics purchasing section.

So, what happens after we complete the negotiation is that the auditors go through the books to make sure that everything that was on the books was the latest provided to the Air Force. In this case it was not provided.

These things are part of the audit function after the negotiations have been completed. In this case we were fortunate that the GAO found this.

Mr. **Bryant**. That is the whole point. It is not necessary to discuss the item or anything else.

The fact of the matter is your auditing system missed it. We called some people who are not in any part of the Air Force to go in there and do a 12-page report for us, and they found it.

Why is that happening? Why did you miss it and why did they find it?

General **Monahan**. Mr. Bryant, I don't know how many million contractual actions we take a year within the Department of Defense. We clearly are not perfect. There is no doubt about that. And once in a while you are going to make an error of that sort. I can't give any better explanation of that.

Mr. **Bryant**. Has anybody ever been passed over for promotion because they failed to catch one of these?

General **Monahan**. I know a lot of people who have been passed over for promotion. I don't know——

Mr. **Bryant**. Is the answer you don't know?

General **Monahan**. That is the answer.

Mr. **Bryant**. You and Major Weber, the contractor on the negotiation, have both been promoted, haven't you?

General **Monahan**. Since when? I think it has been a couple of years for me. I don't know about Major Weber for sure.

Mr. **Bryant**. Since 1982, when all this began.

General **Monahan**. That is true. I think we have saved the F-16 program many hundreds of millions of dollars since 1982, before 1982 and since 1982. You are going to find bigger savings in the future.

Mr. **Bryant**. Mr. Chairman, I think it would be valuable to question Mr. Graham. He is not sitting up here.

Mr. **Dingell**. Mr. Graham, would you come forward to the witness table?

Mr. Graham, you have heard the fashion in which the Subcommittee proceeds with regard to its witnesses. Do you have any objection to being sworn?

Mr. **Graham**. No, sir.

Mr. **Dingell**. Do you desire to have counsel at the table with you to advise you of your rights?

Mr. **Graham**. No, sir.

Mr. **Dingell**. Observe that copies of the rules of the committee and rules of the subcommittee of the House are there to advise you of your rights and the limits on the powers of the committee.

[Witness sworn.]

Mr. **Dingell**. You may consider yourself to be under oath.

The Chair recognizes the gentleman from Texas, Mr. Bryant.

Mr. **Bryant**. Mr. Graham, would you state your position with the Air Force?

TESTIMONY OF LEE GRAHAM, LEAD TECHNICIAN, F-16 AVIONICS SECTION, OGDEN AIR LOGISTICS CENTER, HILL AIR FORCE BASE, UT

Mr. **Graham**. I am an electronic technician.

Mr. **Bryant**. And your full name?

Mr. **Graham**. Lee Graham.

Mr. **Bryant**. Are you the lead technician in the radar repair shop?

Mr. **Graham**. Yes, sir.

Mr. **Bryant**. You were asked to bring some tools with you today. It wasn't clear to me who brought them, but do you have Westinghouse tools with you today?

Mr. **Graham**. I did not bring them but they are here somewhere, yes.

Mr. **Bryant**. Do you have them handy? Could you arrange access for yourself?

Mr. **Graham**. They are on the table, yes.

Mr. **Bryant**. Would you pull them down beside you, because I want to ask you a question about one of them.

The first question I would like to ask you is, in view of the urgent unpriced order, have you ever used any of these tools to repair the antenna on the F-16 until some time after July 1985?

Mr. **Graham**. Prior to July?

Mr. **Bryant**. Yes.

Mr. **Graham**. No, sir.

Mr. **Bryant**. So prior to July 1985, you didn't use any of those tools to repair the antenna on the F-16?

Mr. **Graham**. No.

Mr. **Bryant**. One of the subject parts purchased by the Air Force was called an azimuth motor puller tool for $11,791. It was originally proposed by General Dynamics to cost $23,305.

Would you show us that item?

Mr. **Graham**. This is the item here.

Mr. **Dingell**. While you do that, please, Mr. Graham, can you inform us of whether any of the F-16 radar antennas have been repaired yet for the first time?

Mr. **Graham**. Yes. We have completed five items so far.

Mr. **Dingell**. Five?

Mr. **Graham**. Yes, sir.

Mr. **Dingell**. Were those actual repairs or simulated repairs?

Mr. **Graham**. No, those were full repairs.

Mr. **Dingell**. Full repairs?

Mr. **Graham**. Right.

Mr. **Bryant**. When was that done?

Mr. **Graham**. August and September.

Mr. **Bryant**. Now, the item that you have in your hand there is the azimuth motor puller tool, is that correct?

Mr. **Graham**. Yes.

Mr. **Bryant**. Is that a complex item? That is, could the tool be made in an Air Force machine shop?

Mr. **Graham**. I assume so, but I don't know. We haven't asked anybody to make it.

Mr. **Bryant**. You don't know?

Mr. **Graham**. I don't know.

Mr. **Bryant**. But you have in the past assumed that it could be made——

Mr. **Graham**. It is not unique. It could probably be made in any machine shop, true.

Mr. **Bryant**. Thank you.

One of the urgent items that was procured by the Air Force for delivery in November 1984 was a vacuum heat maintenance stand. Have you ever used this item?

Mr. **Graham**. No, sir.

Mr. **Bryant**. Why not?

Mr. **Graham**. We don't have any technical orders in order to operate the equipment.

Mr. **Bryant**. That is the one you don't have instructions on how to use, is that correct?

Mr. **Graham**. Yes.

Mr. **Bryant**. Does Westinghouse use a tool like this?

Mr. **Graham**. I don't know. I assume they would use one similar, yes.

Mr. **Dingell**. Do you use such a tool at Westinghouse, Mr. Smith?

Mr. **Harry Smith**. We use the tool extensively in manufacturing.

Mr. **Dingell**. Do you use exactly the same tool or a different tool?

Mr. **Bryant**. The question is, do you use it for repair?

Mr. **Harry Smith**. We do not have to use it in repair because there are two aspects of using this tool. We can make what we call a patch, which is what we frequently do, and that is a limited thing. But if we do need to use—incidentally, this tool is compatible with making either patches, a limited section of the antenna or doing the whole thing; the tool is designed to do either.

In the manufacturing facility, we use a tool like it but it is a shop tool.

Mr. **Bryant**. We are just talking about repair here.

Do you use this machine for repair purposes?

Mr. **Harry Smith**. We use it for the patch type of repair. We don't need this machine. We make the patch type of repair and if it gets beyond that, we send it down and use—I will let——

Mr. **Bryant**. Well, the GAO observed in their report that Westinghouse Electronic Repair Center does not use this item for antenna repair. As of July 1985, the maintenance tool was stored in Ogden.

Mr. **Harry Smith**. I think this is semantics and I think Mark could make that clear. We did not duplicate the same facility and requirement in both facilities.

Mr. **Shull**. We use the tool when we have to resurface the antenna. The tool is not located in our depot but we have access to it.

Mr. **Bryant**. Is that the kind of function that the Air Force would ever do itself?

Mr. **Shull**. Yes, sir.

Mr. **Harry Smith**. It is a very important function. We go to great lengths in the design of that antenna to make sure there is no contamination in any of those slots, because if we had any contamination we potentially could get arcing and lose a whole transmitter tube, so it is very important.

We have come up with this patch technique that can be done on the tool.

Mr. **Bryant**. Mr. Graham, if you don't have the tool, how might you repair an antenna without it?

Mr. **Graham**. Not all antennas require this type of repair. Those that we have done did not require it.

Mr. **Bryant**. How many of the subject Westinghouse tools could you have made locally, in your opinion, the one that you have there?

Mr. **Graham**. Personally I make, or have a machine shop make?

Mr. **Bryant**. At the machine shop.

Mr. **Graham**. With the drawings provided, we could not have made any of them; we could not make them without drawings.

Mr. **Bryant**. If you had the drawings, could you make them locally in a machine shop?

Mr. **Graham**. I would assume that any machine shop could probably do it.

Mr. **Bryant**. Do you know when your instructions on how to use this vacuum heat maintenance stand are going to arrive?

Mr. **Graham**. Soon, I hope.

General **Monahan**. They are there now.

Mr. **Bryant**. Mr. Smith, when are you going to send us our instructions?

Mr. **Harry Smith**. They are there. A year ago we sent out our part of the technical orders and I understand that General Dynamics has since created the job and shipped it to the field.

Mr. **Bryant**. That is not what he understands, and he is the guy that fixes the airplanes.

Mr. **Harry Smith**. We have done our part; they are there.

Mr. **Bryant**. Mr. Wood, what about you; are you going to get the instructions to us?

Mr. **Wood**. My information is that the middle of July the instructions and all the TO's were shipped. That is my understanding.

Mr. **Dingell**. Where did they go? Mr. Graham hasn't received them. The General doesn't know where they have been sent. Mr. Smith and Mr. Shull are not aware that they have gone. Were are they?

Mr. **Wood**. I don't know, but I am sure they were shipped to the proper contractual designation.

Mr. **Dingell**. Here you've got a piece of equipment which, according to what Mr. Smith tells us, is of vital importance in repairing this sytem. It has to be there so that you don't short out the entire system, and nobody knows where the technical orders are for it and nobody knows when they are coming.

You tell us, Mr. Wood, you think they have been delivered. General Yates and General Monahan are not aware of their delivery. Mr. Graham, who works on this, is not aware. General Monahan indicates no protest has been made by the Defense Department on this.

General **Monahan**. I believe that General Yates testified here a few moments ago, Mr. Chairman, the technical orders are in two groups: one, a set of technical orders for the earlier group of technical orders for the block 10 airplanes. Those were delivered in May. The technical orders for the F-16, the later models were delivered this month.

Mr. **Bryant**. Why don't you give them to Mr. Graham so he can fix the airplanes?

General **Monahan**. I don't think Mr. Graham has needed them to fix the airplanes up to this time.

Mr. **Bryant**. Then why did you call this an urgent request, urgent priority purchase?

General **Monahan**. I believe we have been over that, Mr. Bryant.

Mr. **Wyden**. I can't figure out why Mr. Graham wanted to sooner; he just told you, he is sitting down the row there.

I appreciate the gentleman yielding.

Mr. **Bryant**. OK. I yield the balance of my time, Mr. Chairman. Thank you.

Mr. **Dingell**. The Chair recognizes the gentleman from Oregon.

Mr. **Bryant**. Mr. Chairman, could I be recognized a moment while he is conferring?

Mr. **Dingell**. The gentleman from Texas.

Mr. **Bryant**. I would like to observe to the gentleman from the Air Force, you may leave this hearing focussing your anxiety or discontent on the individuals of this committee, but probably we will never see each other again, and I think it would be very wise of you to recognize the amount of anger and discontent we express is directly reflective of the people we represent back home who get a chance to renew or un-renew our contracts every 2 years.

I think it would be very valuable for you to take that with you rather than to focus on whether or not we have adequately recognized the good past work you have done for the Government.

No doubt you have done lots of good things. The fact of the matter is we are in a bad budget situation here, and a great deal of the discontent and anger and disgust that I sense in trying to convey this to you doesn't link to you personally whatever.

But there are 525,000 people behind me who feel the same way I do, and not only I know as an intuitive politician, but as the polls indicate. I just suggest to you if you don't do something in a hurry, you will destroy what has been a national consensus for a strong defense for many, many, years.

Thank you, Mr. Chairman.

Mr. DINGELL. Mr. Graham, I would like to return to this pulley puller here. General Dynamics proposed that it be purchased by the Air Force for $13,717. This was negotiated down to $8,832.

Now, Mr. Graham, when this tool was delivered by General Dynamics, did it work for its intended use? The pulley puller, did this work when it was delivered?

Mr. GRAHAM. It was difficult to use, yes. It could be used, but——

Mr. DINGELL. It had to be repaired?

Mr. GRAHAM. Yes; it had to be repaired for ease of maintenance.

Mr. DINGELL. Why?

Mr. GRAHAM. Because it was delivered with a Philips screwdriver head on the bolt rather than a regular bolt head, so we replaced it.

Mr. DINGELL. Now, perhaps General Monahan can answer this. Is it your understanding that General Dynamics is paid to do compatibility testing to be sure the items function properly?

General MONAHAN. Yes.

Mr. DINGELL. Was such done here?

General MONAHAN. Yes.

Mr. DINGELL. It was?

General MONAHAN. Yes.

Mr. DINGELL. And what was the result of that compatibility test?

General MONAHAN. With this particular item, I don't know exactly if this particular screw was removed and another one inserted after the compatibility test, done before, or what.

Mr. DINGELL. Was that done before or after the Senate got after you?

General MONAHAN. I don't believe this had anything to do with actions with the Senate.

Mr. DINGELL. The compatibility test occurred after it was delivered to Mr. Graham in the Air Force at the Air Force base, was it not?

General YATES. No.

Mr. DINGELL. Was the compatibility test before or after it was delivered?

General YATES. Before.

General MONAHAN. The compatibility test is before delivery, Mr. Chairman.

Mr. DINGELL. So it got to Mr. Graham and it didn't work?

General MONAHAN. It may well have been——

Mr. DINGELL. The compatibility test didn't catch the fact that this machine didn't work, did it?

General MONAHAN. This particular item works well in pulling off the antenna pulley if the azimuth and elevation motors have first been removed.

Mr. DINGELL. What is the purpose——

General MONAHAN. It may well have been the test was done that way. I will try to figure out why, Mr. Chairman, it was done that way. If they are on, and we—if the azimuth and antenna motors are still on, it is very difficult with the Philips head type to make that removal.

So compatibility may have been done otherwise.

Mr. DINGELL. What is the purpose of the test? To find out that the item works? Works well? Just barely works? Or doesn't work at all?

General **Yates**. Mr. Chairman, it is the purpose—the purpose is to determine that the item works as it is designed. I don't think in my mind there is any fudging the fact that in this case the compatibility testing, that was done, that was paid for by the Air Force, was insufficient.

Mr. **Dingell**. OK. But it was delivered. Mr. Graham has it out there. He is out there struggling, trying to make this work because the compatibility test didn't catch this thing.

General **Yates**. On this item, I think there is no argument with you, sir, that the compatibility test was insufficient.

Mr. **Dingell**. Now, wasn't General Dynamics paid to do the compatibility testing on this item?

General **Yates**. Yes, sir.

Mr. **Dingell**. Pardon?

General **Yates**. Yes, sir.

Mr. **Dingell**. And Westinghouse, also?

General **Yates**. Yes, sir.

Mr. **Dingell**. Two of our largest corporations supposedly most skilled at running compatibility tests to figure out this thing didn't work very well, is that correct?

General **Yates**. Sir, I don't think that is correct; no, sir.

Mr. **Dingell**. Mr. Graham doesn't think it worked very well.

General **Yates**. What happened was they didn't do a good job on the test. On the tests they ran, it worked fine, but they did not do a complete job of the compatibility testing.

Mr. **Dingell**. But in compatibility, isn't it supposed to work well under all circumstances?

General **Yates**. They didn't do a good job of that.

Mr. **Dingell**. All right. Now, how could General Dynamics deliver an item of this character which doesn't work well when the Air Force pays for all this testing?

General **Monahan**. It is just a case of making a mistake, Mr. Chairman.

Mr. **Dingell**. Do we know the testing occurred?

General **Yates**. Yes.

General **Monahan**. Yes.

Mr. **Dingell**. We do? How?

General **Yates**. We have a report.

Mr. **Dingell**. A report was filed.

General **Yates**. Yes, sir.

Mr. **Dingell**. Will you submit that to the Subcommittee, please?

General **Yates**. Yes, sir.

[The information follows:]

NON-COMPLEX SE

☐ ACCEPTANCE TEST REPORT

☒ COMPATIBILITY TEST REPORT

DATA FILE NO: SERD 74966

REPORT NO: 16ZA749661

STOCK NO.: 5120-01-136-3124

DATE: 11-18-83

SE PART NO.: 3426B73G01

CONTRACT: F33657-82-C-2034

MANUFACTURER: Westinghouse

SE NOMENCLATURE: Pulley Puller Tool, Antenna

SE FUNCTION: TO PROVIDE A MEANS OF REMOVING FRICTION BOUND ANTENNA DRIVE PULLEYS WITHOUT DAMAGE DURING ANTENNA REPAIR/OVERHAUL.

METHOD OF DEMONSTRATION: VERIFICATION OF ACCEPTANCE/COMPATIBILITY TEST PROCEDURE-T-994300.

The undersigned verifies that the compatibility requirements for the above item of SE have been demonstrated and fulfill the SE functions intended. The specified item of SE is suitable for the purpose intended, unless otherwise indicated in the remarks below:

CONTRACTOR ENGINEERING: R.H. Trumble DATE: 11/18/83

CONTRACTOR QUALITY CONTROL: T.M. Ryan DATE: 11/18/83

GOVERNMENT REPRESENTATIVE: DATE: 1/20/84

PE NORRIS

GD REPRESENTATIVE: POAR DATE: 11/21/83

REMARKS:

Mr. **DINGELL**. Let's direct our attention, Mr. Graham, to the alignment pin which I find to be a fascinating subject. General Dynamics proposed a cost of $14,835 for an alignment pin; is that correct?

Mr. **GRAHAM**. I don't know the prices.

Mr. **DINGELL**. Is that correct, General Monahan?

General **MONAHAN**. I beg your pardon, Mr. Chairman.

Mr. **DINGELL**. $14,835 for an alignment pin, General Dynamics proposed that. Is that correct, Mr. Monahan?

General **MONAHAN**. We did not pay that for the alignment pins. We purchased the drawings.

Mr. **DINGELL**. That was proposed.

General **MONAHAN**. We purchased the drawings.

Mr. **DINGELL**. The purchase cost was a little different, but the proposed cost was $14,835; is that right?

Mr. **WOOD**. Mr. Chairman, no, that is not accurate.

Mr. **DINGELL**. What is the accurate figure?

Mr. **WOOD**. It was a not-to-exceed price, but it was 11,000 or something.

Mr. **DINGELL**. How much?

Mr. **WOOD**. In the neighborhood of 11,000, but the not-to-exceed price was 14, I believe, but I am not positive of that either.

Mr. **DINGELL**. You and the GAO have somewhat of a difference on this particular point. The General Accounting Office says that the price proposed by General Dynamics originally dated November 17, 1982 was $14,835.

Mr. **WOOD**. The question, Mr. Chairman, was that the not-to-exceed price, I don't recall.

Mr. **DINGELL**. I don't know.

General **YATES**. Yes.

Mr. **WOOD**. I think it was, sir. That is my comment.

Mr. **DINGELL**. Mr. Quicksall, would you come forward and help us here? We are having trouble here. I guess this is a very large discussion for a small part.

What was the original proposed price from General Dynamics?

Mr. **QUICKSALL**. The original proposed price from General Dynamics was $14,835.

Mr. **DINGELL**. And that was——

Mr. **QUICKSALL**. The not-to-exceed price was another price.

Mr. **DINGELL**. What was that?

Mr. **QUICKSALL**. Sir, I don't remember.

Mr. **DINGELL**. Maybe Mr. Wood can tell us.

Mr. **WOOD**. Mr. Chairman, I think I have it accurately portrayed now. We are both right, by the way. He was looking at the original proposal of November 17, 1982. I believe that was the not-to-exceed number, $14,835. The revised proposal is July 12, 1983 which does not include that update, was $9,376.

So we are both right really.

Mr. **DINGELL**. Thank you.

Now, Mr. Graham, is this alignment pin a very complex item?

Mr. **GRAHAM**. No.

Mr. **DINGELL**. What is it?

Mr. **GRAHAM**. It is a pin to hold the motor while you put the screws in it to re-attach it to the assembly.

Mr. DINGELL. Mr. Smith, what did Westinghouse use for this pin?

Mr. HARRY SMITH. The thing we have used most has been a wooden stick.

Mr. DINGELL. A wooden stick?

Mr. HARRY SMITH. Yes.

Mr. DINGELL. You have made some copies of this pin, have you not, Mr. Graham?

Mr. GRAHAM. I didn't know if I was going to get them on time and so cut them.

Mr. DINGELL. You made them yourself?

Mr. GRAHAM. Yes.

Mr. DINGELL. How did you make them, out of what?

Mr. GRAHAM. I went to our machine shop and just cut them out of some stock metal that was there.

Mr. DINGELL. What kind of wire did you use to make them out of?

Mr. GRAHAM. Just what was in there.

Mr. DINGELL. Beg your pardon?

Mr. GRAHAM. It was just iron stock in the machine shop.

Mr. DINGELL. How long did it take you to make them?

Mr. GRAHAM. Ten minutes.

Mr. DINGELL. How much?

Mr. GRAHAM. Probably 10 minutes.

Mr. DINGELL. What did you do?

Mr. GRAHAM. What did I do?

Mr. DINGELL. Yes, to make them.

Mr. GRAHAM. I had the machinist cut them off.

Mr. DINGELL. Cut them off, machine them off?

Mr. GRAHAM. Cut them off to the right length.

Mr. DINGELL. What did you do to cut them off?

Mr. GRAHAM. I don't know. I didn't watch the operation. I just told the machinist I needed two pieces of metal a certain diameter and a certain length.

Mr. DINGELL. What was the approximate diameter of these pieces of metal?

Mr. GRAHAM. I can't remember. About sixty-thousandths. I am not sure.

Mr. DINGELL. How much?

Mr. GRAHAM. About sixty-thousandths.

Mr. DINGELL. Approximately the same size as a piece of coat hanger wire.

Mr. GRAHAM. Approximately.

Mr. DINGELL. Approximately. Did they use coat hanger wire to put them together, to make them?

Mr. GRAHAM. I don't think so, no.

Mr. DINGELL. Could they have been cut out of a piece of coat hanger wire?

Mr. GRAHAM. I don't know the diameter of coat hanger wire and I wouldn't say it would fit or not fit. It could conceivably work, I don't know.

Mr. DINGELL. Thank you.

Mr. HARRY SMITH. Mr. Chairman, I have a drawing for you.

Mr. DINGELL. Excuse me.

Mr. **Harry Smith**. If you are interested, I have a copy of the drawing.

Mr. **Dingell**. That would be very useful and staff will bring it up here. I think that would help us here.

Mr. **Harry Smith**. This is a sophisticated drawing.

Mr. **Dingell**. Thank you.

The Chair recognizes the gentleman from Oregon.

Mr. **Wyden**. Thank you, Mr. Chairman.

General Monahan, the GAO report and in their testing indicates that two corporations, General Dynamics and Westinghouse, got together to double bill the Government for the existing Westinghouse antenna repair tools. Were you, General Monahan, aware that several sets of the tools had been previously developed?

General **Monahan**. Well, as General Yates and I explained earlier, that is where we started the tool definition and acquisition process. We start with the tools developed by Westinghouse and we do not re-develop the tools. We simply introduce them into the Air Force inventory after sufficient engineering, procurement drawings, compatibility testing, calibration, all those sorts of things have been accomplished.

We start with—every one of these tools had its origin with what Westinghouse was using. We changed some of those.

Mr. **Wyden**. Were you aware the Government had already paid for them?

General **Monahan**. Yes, very definitely, and we did not pay again.

Mr. **Wyden**. OK.

General **Monahan**. For the effort we paid for originally.

Mr. **Wyden**. And at that point you were just prepared to go through it all over again?

General **Monahan**. No. We did not go through it all over again. As I said, we took those actions necessary to bring it into the Air Force maintenance system to put it in a depot that is going to last for 30 years. Wooden sticks will not last for 30 years.

Mr. **Wyden**. Did General——

General **Monahan**. Neither will coat hangers.

Mr. **Wyden**. Did they lead you astray?

General **Monahan**. No, definitely not.

Mr. **Wyden**. What happened? You depend on and you paid General Dynamics to make the correct support equipment recommendations, don't you?

General **Monahan**. That is true.

Mr. **Wyden**. And they recommended to you that it just be done again?

General **Monahan**. No. That is not what they recommended?

Mr. **Wyden**. What did they recommend to you exactly?

General **Monahan**. They recommended to us that we introduce these items into the Air Force maintenance system.

Mr. **Wyden**. Well, you are dependent on General Dynamics to recommend the most cost effective tools.

General **Monahan**. We work it together between us, ourselves and General Dynamics, that is true.

Mr. **Wyden**. Made General Dynamics to recommend tools; is that correct?

General **Monahan**. Yes.

Mr. **Wyden**. Isn't it true that General Dynamics also pays Westinghouse to recommend the most cost-effective tools?

General **Monahan**. Westinghouse is a subcontractor to General Dynamics in this case. I don't know what arrangement there was between the two.

Mr. **Wyden**. It just looks to me like everybody is paid to manage these items, but instead they get together to take advantage of the taxpayers and to do that, as you know, is combination in crime.

The fact is that none of this could have gone on unless the Air Force was in some way involved. Did you send any technicians out to observe the repair procedures, or pick up extra sets of tools? What did you do to try to stop this?

General **Monahan**. First of all, Mr. Wyden, there is no reason to try to stop anything. The method that we were proceeding with here is the method that is accepted and is the one that will end up in having an enduring and durable and permanent depot level maintenance capability.

So there is no way in the world I would have wanted to stop anything that I saw happening here throughout the process.

Mr. **Wyden**. Did you send any technicians to Westinghouse to look at repair procedures?

General **Monahan**. I did not have any trained APG-66 radar technicians to be able to send. We don't have people available to us to be able to do that kind of thing.

Now, we have about 1,000 or 1,500 of those sorts of reviews that we would have to go through. We don't have enough people to be able to do that.

Mr. **Wyden**. Mr. Graham looks like a good technician.

General **Monahan**. Fine. But I don't know how many places we can send Mr. Graham to. With all the things we have to do in the reviews that would have to be made, we would have Mr. Graham and many like him on the road constantly. We can't do that.

Mr. Graham is hired to be an avionics technician and perform a repair on our avionics components.

Mr. **Wyden**. Well, I——

General **Monahan**. We relied on General Dynamics to do that sort of visit, but—this is a very important point—we used the tools that Westinghouse developed with necessary modifications.

For example, we did not use wooden sticks. We used steel pins instead.

So when we develop the radar, and it was a contract with the U.S. Air Force under which the radar was developed and under which production was initiated, it was necessary for Westinghouse to develop the necessary tools to be able to take the radar apart and put it back together again.

We paid for that effort at that time. We did not pay for that effort again.

Mr. **Wyden**. Well, it——

Mr. **Dingell**. Would the gentleman yield?

Mr. **Wyden**. Be happy to yield.

Mr. **Dingell**. You mentioned antenna tools that Westinghouse used. I am looking at appendix 1, page 14, vendor manufactured, Westinghouse Electric Corp., brush assembly tool. Function, retract

F-16 antenna azimuth and elevation drive motor brush assembly in assembling motors at the depot.

GAO observation: Westinghouse Electric repair center does not use this tool for antenna repair. Document definitizing price, contract modification, PKOO-97 dated May 14, price negotiated by the Air Force March 19, 1984, $10,624.

Westinghouse doesn't even use this tool.

General **MONAHAN**. Westinghouse uses a tool but it is not the same as the one we ultimately procured. They used a tool that was not durable, that didn't last and had a high potential of doing an improper job of installation. That was the piece of plastic brought up earlier. We are not going to use pieces of plastic in maintaining that $95,000 radar.

Mr. **WYDEN**. Mr. Monahan, how did Westhinghouse manage to repair 2,200 radar systems over 5 years with inadequate tools?

General **MONAHAN**. Westinghouse has people who are living with the radar, who developed it, who spent years engineering it taking it apart and putting it back together on a daily basis. That is a very big difference than the sort of thing we have to do.

Mr. **DINGELL**. Let's inquire of Mr. Shull and Mr. Smith. How many radars did you repair with your tool?

Mr. **SHULL**. We have repaired approximately 2000 radars, antennas.

Mr. **DINGELL**. In the course of those repairs, did you ever have any trouble using the tools that you used?

Mr. **SHULL**. This tool is awkward to use if you use a piece of plastic, and you should be highly trained. There are parts of the brush assembly when you are installing that you should not touch. In using this plastic you are very likely to touch it. That is why we developed these tools for the Air Force.

Mr. **DINGELL**. What is the tool that Westinghouse uses?

Mr. **SHULL**. We use a piece of plastic strip.

Mr. **DINGELL**. How big and how thick?

Mr. **SHULL**. I believe it is approximately 3 by 8.

Mr. **DINGELL**. How much does it cost Westinghouse?

Mr. **SHULL**. I do not know, sir.

Mr. **DINGELL**. Approximately?

Mr. **SHULL**. I have no idea.

Mr. **DINGELL**. If you ran out to the store to buy a piece of plastic like that, what would you expect to pay?

Mr. **SHULL**. It would be relatively cheap.

Mr. **DINGELL**. Rather less, I gather, than 10,624?

Mr. **SHULL**. Yes, sir.

Mr. **HARRY SMITH**. Incidentally, the change is simply taking that piece of plastic which is a technique, this is a little small, picture this 8 inches, the technician wraps it around and has enough dexterity that he can insert the assembly in there. Now, all we did was just make a piece of plastic into a cone of plastic.

Mr. **DINGELL**. What is the tool then that was sold, the device called "brush assembly tool"?

Mr. **HARRY SMITH**. That is this series of cones used to do it, plastic cones.

Mr. **DINGELL**. The Chair thanks the gentleman.

Mr. **Wyden**. Mr. Chairman, I think the Air Force system defies common sense. The last point with respect to the adequacy of tools where Westinghouse is repairing 2,200 radar systems over 5 years with what are called inadequate tools, I think, shows how absurd this system has become in a nutshell. I thank the Chairman.

Mr. **Dingell**. The gentleman from Minnesota.

Mr. **Sikorski**. Thank you, Mr. Chairman.

I would like to talk to Mr. Kent Sutherland who, as I understand, is the equipment specialist. He is listed on our list of panelists from the U.S. Air Force.

Mr. **Dingell**. You have heard the preliminary remarks of the Chair with respect to each of the witnesses who appear before us. Do you have any objection to testifying under oath?

Mr **Sutherland**. No, sir.

Mr. **Dingell**. Do you desire to have the advantage or benefit of advice of counsel during your appearance before the committee?

Mr. **Sutherland**. No, sir.

Mr. **Dingell**. For your information and assistance in knowing your rights and the limits on the powers of the committee, copies of the rules of the subcommittee and rules of the House and rules of the committee are there on the table before you. Will you then please raise your right hand.

[Witness sworn.]

Mr. **Dingell**. You may consider yourself under oath. Take your seat. The Chair recognizes the gentleman from Minnesota.

Mr. **Sikorski**. I thank the Chairman.

Mr. Sutherland, could you explain for us your responsibility with regard to the support equipment items that are the subject of this hearing?

TESTIMONY OF KENT SUTHERLAND, EQUIPMENT SPECIALIST, SERD COMMITTEE, OGDEN AIR LOGISTICS CENTER, HILL AIR FORCE BASE, UT

Mr. **Sutherland**. Yes, sir. My responsibility is to serve as coordinator on the SERD Committee, I represent several technicians for the avionics systems, not only radar but others. As each technician reviews the SERD's as they come through I make sure they get the SERD, evaluate it, and I review their comments. I consolidate these comments and represent the technicians at the SERD review committee.

Mr. **Sikorski**. As I understand the SERD is the acronym for support equipment recommendations data.

Mr. **Sutherland**. Yes.

Mr. **Sikorski**. You are an equipment specialist and you consider the need for the item from a technical standpoint. Is that fair?

Mr. **Sutherland**. Yes, sir.

Mr. **Sikorski**. I have a letter dated September 5, 1983.

Mr. **Dingell**. Without objection the document referred to will be inserted in the record.

[The document follows:]

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS OGDEN AIR LOGISTICS CENTER (AFLC)
HILL AIR FORCE BASE, UTAH 84056

SEP 05 1983

REPLY TO ATTN OF: MMAR

SUBJECT: F-16 Support Equipment Overpricing

TO: ASD/YPEG Aero System Division, Wright Patt, AFB

1. We have received calls from a price investigation team convened to investigate contractor overpricing. We were advised that Westinghouse has provided firm pricing for the following SERDs used in repair of the F-16 Fire Control Radar Antenna:

			AIR FORCE (SPO)	WESTINGHOUSE
	SERD	NOUN	ESTIMATED PRICE	PRICE
1	74966	Pulley Puller Tool, Antenna	$6,000.00	$11,000.00
2	74967	Antenna Clamp Alignment Tool	6,000.00	9,600.00
3	74968	Shaft Positioner Tool, Azimuth	6,000.00	32,800.00
4	74969	Shaft Positioner Tool, Elevation	6,000.00	32,800.00
5	74970	Motor Puller Tool, Azimuth	6,000.00	17,000.00
6	74971	Motor Puller Tool, Elevation	6,000.00	16,000.00
7	74972	Height Gage, Antenna Pulley	6,000.00	10,900.00
8	74973	Motor Stator Keeper, Azimuth	6,000.00	9,400.00
9	74974	Motor Stator Keeper, Elevation	6,000.00	9,400.00
10	74975	Antenna Tape Block Tool	6,000.00	9,900.00
11	74977	Hexagon Wrench Antenna	6,000.00	9,600.00
12	74978	Alignment Pin, Antenna Motor Assy	6,000.00	9,400.00
13	74979	Brush Assy Tool, Antenna Motor	6,000.00	10,100.00
14	74882	Dummy Load	500.00	5,700.00

2. The investigating team considers the contractor price to be very excessive. We have not received a formal price quote from GD/FW confirming the above Westinghouse costs. However, we completely agree with analysis of overpricing of these items.

3. During SERD evaluation, we approved these SERDs as required items for Depot repair. However, the only price we have seen is a price provided at the preliminary SERD review by ASD/YPEC for cataloging actions only.

If the above Westinghouse prices are firm, we recommend consideration given to obtaining another source for these items. Most of these SERDs simple designed items and manufacture cost should be minimal. With ception of SERD 74882, none should exceed $500.00. If drawings are avail- e, local manufacture or manufacture by another firm should be considered.

Price evaluation of support equipment should not be limited to above Ds. Other SERDs recommended by Westinghouse and other contractors should given close evaluation for overpricing.

6. If we can be of further assistance, please advise. Point of contact is Kent Sutherland, OO-ALC/MMARE/AV 458-5871.

Arnold J. Theisen

OLD J. THEISEN
CHIEF, ENG, REL BR
F-16 ACQUISITION DIV

Mr. **Sikorski**. I thank the chairman.

You told GAO that you prepared that or helped prepare that letter; is that accurate?

Mr. **Sutherland**. This is true, yes.

Mr. **Sikorski**. Isn't it correct that you said in the letter that none of the Westinghouse items should exceed $500, I think with the exception of SERD 74882, is that correct?

Mr. **Sutherland**. This is true.

Mr. **Sikorski**. I think you said in the—it is signed by Arnold J. Theisen?

Mr. **Sutherland**. Yes.

Mr. **Sikorski**. Is he your supervisor?

Mr. **Sutherland**. He is my supervisor.

Mr. **Sikorski**. In that letter, it says if the above Westinghouse prices are firm, and these are listed as the Westinghouse price for 14 items from the pulley puller tool to the dummy load, we recommend consideration be given to obtaining another source for these items.

Most of these SERD's are simple design items and manufacture costs should be minimal.

That is important because we heard testimony there is a major generic or organic difference between the four that were manufactured by the Air Force and the others that were not.

Some several factors different in price.

With the exception of SERD 74882—and that I understand is the RFload.

Mr. **Sutherland**. Yes.

Mr. **Sikorski**. With that exception none should exceed $500. If drawings are available, local manufacturers or manufacture by another firm should be considered. Price evaluation of support equipment, it goes on to say, should not be limited to above SERD's. Other SERD's recommended by the Westinghouse and other contractors should be given close evaluation for overpricing.

Those are your words, sir.

Mr. **Sutherland**. Yes, sir.

Mr. **Sikorski**. In July 1982, did you approve the purchase of these same items? The SERD team?

Mr. **Sutherland**. Through the team, yes. I took the technician's advice. It is for a requirement, a valid requirement, they all seemed to be valid requirements.

Mr. **Sikorski**. And that requirement went to need.

Mr. **Sutherland**. To need.

Mr. **Sikorski**. Not to price.

Mr. **Sutherland**. No, sir.

Mr. **Sikorski**. Although you were concerned about the price.

Mr. **Sutherland**. Yes, sir.

Mr. **Sikorski**. In that, Air Force regulation was at 66–68 requires you to consider these items for local manufacture, too, though, doesn't it?

Mr. **Sutherland**. Yes.

Mr. **Sikorski**. But evidently they didn't get considered for local manufacture?

Mr. Sutherland. They were considered but without drawings it is difficult. The price recommendation in my letter was for labor and material only. I did not have the drawings.

Mr. Sikorski. It is true you were not aware that drawings or sketches existed at Westinghouse for the tools that performed the same maintenance function as the subject items, is that correct?

Mr. Sutherland. I would assume that they would be there, that it would have to be purchased through the contract.

Mr. Sikorski. But at the time you made the recommendation eliminating consideration of local manufacture, what you just said was based on the fact there were no drawings. You didn't know there were drawings and sketches for similar tools performing the same function, is that correct?

Mr. Sutherland. It must be assumed that if they have tools they must have had drawings to make and use those tools.

Mr. Sikorski. I thought you told our people that you weren't aware that drawings or sketches existed at Westinghouse.

Mr. Sutherland. We did not have Air Force drawings.

Mr. Sikorski. As a member of the support equipment recommendation data team, the SERD team, you should be aware of existing tools though.

Mr. Sutherland. Yes, we were aware of existing tools.

Mr. Sikorski. What happened in that case? You were aware there were existing tools and you assumed there were drawings for those existing tools——

Mr. Wyden. I want to apologize to my colleague.

Mr. Sikorski. That is OK.

What happened? How come they were not considered for local manufacture?

2:30 p.m.

Mr. Sutherland. They were considered for local manufacture.

Mr. Sikorski. But you didn't have drawings?

Mr. Sutherland. We didn't have drawings. We had sketches that came with the SERD.

Mr. Dingell. The chairman asks a question, what is the difference between a drawing and a sketch?

Mr. Sutherland. A sketch is an artist's conception of what something may be. A drawing—what we use as manufacturer's drawings is Air Force drawings that have been done by draftsmen, or engineers that provide dimensional material, whatever it may be, to actually do this.

Mr. Dingell. Would the gentleman yield? Doesn't a sketch give the dimensions?

Mr. Sutherland. Not necessarily.

Mr. Dingell. Not necessarily, but may it? A sketch may include dimensions?

Mr. Sutherland. It perhaps would, but we cannot manufacture from drawings that are sketches. Our regs tell us that.

Mr. Sikorski. The regs tell us about buying the hexagon tool, the allignment pin. What did they buy, drawings or sketches?

Mr. Sutherland. I have not seen the drawings yet. I am sure there are drawings. When we buy them, the only thing I have ever seen used has been official Air Force drawings.

Mr. **Sikorski**. They cost $44 a piece, and they got them from—well, does anybody on the SERD team review for price and cost effectiveness?

Mr. **Sutherland**. We look at them, but the costs that we see are an estimated, not to exceed price, and it isn't a price that we can say, hey, this is the price it is going to be. Uniform, it is an estimated price or not to exceed price.

Mr. **Sikorski**. But your team is not in charge of reviewing for reasonableness of prices?

Mr. **Sutherland**. We are charged with reviewing the use and the requirements.

Mr. **Sikorski**. You did raise the issue to your credit. At what point in this process does anybody in the Government become concerned with prices?

Wouldn't it be to the advantage of the Air Force for your committee, the support equipment recommendation data team, to be concerned about reasonableness of prices, before these items are put on contract?

Mr. **Sutherland**. Yes, sir, it would.

Mr. **Sikorski**. Because you get unpriced contracts, and as I understand the court cases, notwithstanding the comments that we had earlier today, once that contract goes, the price is driven by the contractor, and the taxpayers carry a very heavy burden according to the words of the courts, a very heavy burden to overturn what the contractor says is a reasonable price.

The price is a procurement responsibility, isn't it?

Mr. **Sutherland**. Yes, sir.

Mr. **Sikorski**. It has to go not hand in hand with need.

Mr. **Sutherland**. At the point of time we look at it, it is not hand in hand. At the time we look at it, it is a need more than it is a price. If it is needed, we can't let a price override us.

If we need something to repair something, it is a requirement.

Mr. **Sikorski**. The question, then, logically with just these examples is how do you know there is the need there for that tool other than the comment from General Dynamics and the comment from Westinghouse?

We know we have a stand that hasn't been used, we know we have some diode device that has been lost, and we know we have an alignment pin that has been changed, and we went to a lot cheaper system, and on and on.

Mr. **Sutherland**. We must rely on contractor recommendations early in the SERD processing cycle.

Mr. **Sikorski**. Well, here is the rub. We have the contractor here, the general contractor says they don't have a fiduciary responsibility to look for the most cost-effective way, and we have the Air Force saying we don't have a fiduciary responsibility to look for the most cost-effective way, we are to look for need. The need is certified by the contractors and we have a happy little chain here.

The only people getting taken is the taxpayers.

Mr. **Wyden**. What happened to the AFPRO protest?

Mr. **Sutherland**. I am not aware of the AFPRO protest; it's not my area.

Mr. **Dingell**. Would the gentleman yield? Here we have the Air Force, the contractors and the subcontractors. Who is supposed to see to it that this is done in the most cost-efficient fashion, the Air Force, General Monahan?

General MONAHAN. Absolutely. By the way, I think all Americans share in that responsibility, but I will say that the Air Force has the prime responsibility, that is not to let anybody else off the hook, either.

Mr. DINGELL. I am comforted to hear that. Maybe Mr. Harry Smith and Mr. Shull and Mr. Cook could tell us. Do you have at Westinghouse a duty to see that these things are done in the most cost-effective fashion?

Mr. HARRY SMITH. Certainly.

Mr. DINGELL. Mr. Smith and Mr. Wood?

Mr. WOOD. We try to exercise the most cost-effective business judgment, everything considered.

Mr. DINGELL. Do you have a duty to see to it that these things are done in the most cost-effective fashion?

Mr. WOOD. I would have to say no, then. I would like to explain why then.

Mr. DINGELL. When you tell us you don't have a duty to do it in the most cost-effective fashion, I think you have not only the right, but the duty to explain why you make that statement.

Mr. WOOD. I think it is incumbent upon all of us to develop a process that would result in the most cost-effective way of doing business. In many ways, the processes we use in any part of government are not specifically designed to be the most cost effective.

Mr. SIKORSKI. Well, Mr. Wood, you told us earlier that you don't feel you have a fiduciary responsibility to produce the most cost-effective items. If I were to design a process, I would decertify General Dynamics and that would help us get to a more cost-effective way of doing that.

Generals, do you feel good about the statement of General Dynamics about what their responsibility is under the contract? As I understand the contract, they are being paid $10 million a year to recommend these items to repair and maintain the radar, and that their responsibility is to recommend the most cost-efficient, the most cost-effective manner of presenting it.

They say no, they only have to recommend.

General MONAHAN. My answer to your question of "do I feel good about that answer," is no; I don't.

Mr. SIKORSKI. Is it your understanding that their contractual responsibilities to the Air Force are to come up with the best recommendations on need and cost effectiveness?

General MONAHAN. That is right, sir. I don't want to try to interpret what Mr. Wood is getting at, but I am interpreting his remarks that in a broad sense, the Government——

Mr. SIKORSKI. General Yates, you don't have to bail out Mr. Wood.

General MONAHAN. I am not trying to.

Mr. SIKORSKI. He said twice now, earlier today and now after reflection—even though Westinghouse came up with a different response, and you did, too—they don't have the responsibility and someone better get that contract out, look at it, and either change it, if it isn't in there, or push General Dynamics to meet it.

This is the vice president for contracts and pricing for General Dynamics. He was, for almost 15 years—no, 25 years, over 20 years, a——

Mr. Wood. Wrong, sir. 17 years, sir.

Mr. Sikorski. Seventeen years, an employee of the Government doing the same kind of stuff that you people are doing in this procurement system, this acquisition system.

Mr. Wyden. Would the gentleman yield?

Mr. Sikorski. Sure.

Mr. Wyden. Mr. Wood, I just thought that was a mind-boggling statement. I think the taxpayers of this country want you to build cost effectiveness into absolutely everything that you do, and to think otherwise I think is just to be absolutely unaware of what the citizens of this country are saying.

This is one of the top concerns on their mind today, that they get value for their defense dollar, and for you as the Nation's largest defense contractor to come here and almost cavalierly dismiss the issue of cost-effective, I think is a mind-boggling statement.

Mr. Wood. I can't let that go unanswered. You totally misconstrued what I said. I said that I did not believe that in most governmental activities, they were designed to be the most cost effective and you can't possibly disagree with that, sir, sitting where you sit.

Mr. Wyden. Everything that we are trying to do is to build cost-effectiveness into Government and for some reason, you think, on the basis of your response now to Mr. Sikorski, and I believe the chairman that defense is exempt and it is not going to be that way.

Mr. Sikorski. What is disturbing is you were for 17 years working on this side, and now I understand while you are at General Dynamics, you don't believe the defense contractor has the responsibility to recommend the most cost-effective way of procuring these items to repair 55 billion dollars' worth of equipment that your corporation is selling the taxpayers.

It is mind-boggling as the gentleman said. But scary besides, because you were on both sides of this issue. You were, for 17 years, on the side of buying this for the taxpayers, and now for the last 6 or 7 years, on the side of selling it to the taxpayers. We hear the Air Force, through different people in the system, we hear subcontractors all say that the contractor has an obligation to not only recommend what is necessary, what is needed, but also what is cost-effective and you say no, you don't.

It is a sad day. I thank the chairman.

Mr. Dingell. The time of the gentleman has expired.

The Chair has some questions now in cooperation with the General Accounting Office, for Mr. Harry Smith.

Mr. Smith, the Chair has received today and at other times communications from the GAO, either statements or testimony that indicated that Westinghouse did not fully cooperate with GAO in this review.

For example, Mr. Quicksall testified that Westinghouse refused to allow his team to interview engineers who claim to have spent 63 hours in solemn contemplation of a 3-inch piece of wire.

Could you explain to us why you refused to allow GAO to inquire of your engineers on that matter?

Mr. **Harry Smith**. Well, since you have addressed the question to me, I will answer it and let perhaps our contracts man embellish it if you would like.

Mr. **Dingell**. Is this as a result of policy at Westinghouse?

Mr. **Harry Smith**. Yes; fundamentally, it is an attempt to keep things kind of to the subject and particularly with the kind of complex process where there are so many items of what we call engineering consisting of so many things.

There are so many people involved we like to get things in writing, so that we would like to direct that question to the person whom we think is most competent to answer it.

Believe me, we are not trying to hide anything.

Mr. **Dingell**. Is this a matter of policy?

Mr. **Harry Smith**. It is something that we have developed over the years, and in working with the GAO. And it has usually worked out. I mean, we usually get a little early negotiation and see what resistance, but I think on balance, we have found that this really hasn't inhibited getting the facts, and believe me, we are as interested as anyone that the correct facts be gotten.

Mr. **Dingell**. By what authority do you do this, by what statutory authority?

Mr. **Harry Smith**. Really, it is by negotiation. We suggest this method, and we usually have been able to come to an agreement that this—I say after a little bit of initial reaction, that this works out to be satisfactory.

If there is any particular area, I guess you are talking about the 63 hours, why——

Mr. **Dingell**. Do you do this with other committees of the Congress?

Mr. **Cook**. As an internal procedure, we have just developed that.

Mr. **Dingell**. You have just developed it?

Mr. **Cook**. Not just developed, but we have had that procedure and found it works better for both the people asking the questions, as well as for us who are supplying it to you.

Mr. **Dingell**. I hope you are not offended if I come to the conclusion that it does not work better for this Subcommittee, and that it is our intention that when we send people out to interview that they shall conduct the interview. We have two ways of achieving proper cooperation here.

One is called the pleasant way, in which everybody cooperates, and one is called the unpleasant way, in which folks don't cooperate. It is the record of this Subcommittee that those who do not cooperate oftentimes not only leave Government, but sometimes go to jail.

I will present you with a list of those who have chosen to flaunt the authority of the Subcommittee in this fashion. I want to make it very clear that the GAO will be back to interview this engineer, and they will be reporting to us to inform us that you have provided full cooperation.

If you do not provide full cooperation, we would expect that you will also communicate with us so that we may encourage Westinghouse toward greater cooperation.

In that event, the Subcommittee will be compelled, reluctantly, but I think necessarily, to choose the unpleasant fashion of producing the cooperation. Mr. Smith, are we going to have the cooperation of Westinghouse in these interviews or are we not?

Mr. **Harry Smith**. I would expect so.

Mr. **Dingell**. Mr. Quicksall will be communicating with you about these matters, and we will take steps for the necessary appointments, so that he may carry forward the interviews with folks we want interviewed.

If he doesn't get the necessary and appropriate cooperation, we will have another meeting in this Subcommittee room where perhaps the committee will discuss compulsory process or perhaps matters relative to contempt or other things.

We are going to have our agents at the GAO conduct the necessary inquiry and you are going to cooperate and we hope it will be done with a remarkable spirit of good will, but if not, it will be done in any event.

Mr. **Harry Smith**. It is not our attempt to try to resist that process.

Mr. **Dingell**. You have given that viewpoint. The way that will be corrected is by the fullest cooperation with Mr. Quicksall, so he can report to us that you have been cooperating in full, and so, we will look forward to your full assistance to Mr. Quicksall and the folks at GAO, so that the chairman of this subcommittee and this committee won't have to get properly outraged and have another unpleasant session of this subcommittee to discuss these matters.

The Chair announces that the Chair has to leave the room. The Chair is going to request that the gentleman from Oregon preside and the Chair thanks all present.

The gentleman from Oregon will assume the Chair.

Mr. **Wyden** [presiding]. Mr. Smith, we had testimony from the DCAA and Joe Sherick, the Pentagon IG, in April 1985, about the lack of cooperation by Westinghouse with both the DCAA and the Inspector General.

We were told that during a recent DCAA audit, DCAA requested access to an internal audit of Westinghouse which allegedly pertained to an embezzlement scheme. This audit was done at government expense.

Westinghouse refuses to give DCAA access to the audit. Subsequently, the IG had to subpoena the audit. Westinghouse is still in the process of fighting the IG subpoena in the courts.

Mr. Sherrick has been extremely critical about Westinghouse's lack of cooperation. The subcommittee would like to know what is going on.

Mr. **Harry Smith**. I will attempt to answer that, although remember, I am not a lawyer, and this thing is is, as you note, in the courts. I guess I can give you my impression of what our corporation is concerned about, and it is simply the sanctity of the internal audit process, and I think this view, incidentally, is shared by many segments of the accounting profession, as well as industries that do business with both the Government and commercial work, and simply stated, we feel that while we have no—nothing specific to hide from the DCAA or anyone else, that public disclosure of this kind inhibits the internal audit process in that—the whole purpose of the internal audit process——

Mr. **Wyden**. Mr. Smith, this is a 100-percent government division.

Mr. **Harry Smith**. But this is corporate. This is a corporate issue, and that is why this is being handled as a corporatewide concern. And that is because we are both commercial——

Mr. **Wyden**. Why shouldn't the taxpayers know if there is an embezzlement going on in a 100-percent government division?

Mr. **Harry Smith**. Certainly. This has nothing to do in my view with what is going on. It is the principle and the process, the sanctity of which we are trying to preserve. To enable us to find even easier——

Mr. **Wyden**. Is there embezzlement going on, Mr. Smith?

Mr. **Harry Smith**. Certainly not.

Mr. **Wyden**. Was there evidence of embezzlement?

Mr. **Harry Smith**. We had had, as a result of our internal audit over years, many years, and that would apply throughout the corporation, specific instances of people—"defalcation" I think is the word we tend to use, which we correct, fine and punish the people. So, the internal audit system does work.

Mr. **Wyden**. When was the most recent incident of embezzlement?

Mr. **Harry Smith**. I wouldn't use the word embezzlement. These things I am talking about are relatively small amounts of money which we classify as defalcation, and we have had a handful of these over the last 5 years uncovered, to give you my assessment—and these are involving things like $5,000, $10,000, and they are strictly employees not doing what they are supposed to do.

Mr. **Wyden**. Will you submit copies of the relevant audits to the subcommittee?

Mr. **Harry Smith**. I think—well, certainly. That is not within my purview to agree to at this point, since this is——

Mr. **Wyden**. But, you are speaking for the corporation, and since these are small amounts, there shouldn't be any problem getting the relevant audits——

Mr. **Harry Smith**. Again, it is a matter of principle, not substance. We have nothing that we are particularly trying to hide in our stand on this issue. Believe me, it is more a policy and principle, and as I said, I believe it is shared by many segments of the accounting community.

Mr. **Wyden**. Well, it is a matter of principle to us as well, Mr. Smith. This is the taxpayers' money, it is a government division, so we will be expecting copies of the relevant audits to the subcommittee.

Mr. **Harry Smith**. Let me just conclude by saying the reason we took it to the courts is something that we don't decide on its relative merits of this issue or that issue, but as a matter of policy, and this policy is being tested in the courts.

Mr. **Wyden**. A question for Mr. Robert Smith.

Were you aware that Westinghouse had repaired the radar antenna for the Air Force for the past 5 years?

Mr. **Robert Smith**. Yes, I was.

Mr. **Wyden**. What was your function with respect to this assignment?

Mr. **Robert Smith**. At this time period?

Mr. **Wyden**. Yes.

Mr. **Robert Smith**. I served as a project engineer in which all of the support equipment recommendations, or if you will, the SERD's passed through me for administrative review.

Mr. **Wyden**. Does the gentleman from Texas want me to yield to him?

Mr. **Bryant**. Are you through?

Mr. **Wyden**. The Chair will recognize the gentleman from Texas.

Mr. **Bryant**. Mr. Sutherland, do you know a fellow named Colonel Bodenhammer, who was the Air Force plant representative officer?

Mr. **Sutherland**. No, sir, I don't.

Mr. **Bryant**. How about Major General Monahan, did you know him, Colonel Bodenhammer?

General **Monahan**. Yes.

Mr. **Bryant**. And his job was Air Force plant representative officer, am I correct?

General **Monahan**. He was commander of the Air Force plant representative office, commander of that office.

Mr. **Bryant**. Any General Dynamics?

General **Monahan**. Yes.

Mr. **Bryant**. Where?

General **Monahan**. At Fort Worth, Texas.

Mr. **Bryant**. He protested, did he not, the whole price list that we have been discussing here today?

General **Monahan**. Yes, in April 1983—I think protest is perhaps the wrong word. He informed General Dynamics that the proposal that they had submitted to us, the price for the tools in question here, was too high, and the government was not going to accept that, and it was not acceptable for negotiation.

So, we sent a letter back to them, and told them to repropose. What is good about that is that particular action was initiated down at the lower levels of where we and the contractors have the ability to look for things such as overpricing.

The good part about it is that Colonel Bodenhammer's people found it, and he informed me of it, and was able to take care of it, and eventually got the contractor to repropose, and we got the price for half of what the original proposal was.

Mr. **Bryant**. You are acting like you followed Colonel Bodenhammer's advice. Let me lay that out more clearly.

He wrote a letter to General Dynamics stating that the prices to the Air Force for single piece items were in the $9,000 to $11,000 category, which from all appearances should be been priced between $2 and $150.

The letter also stated that the assemblies were priced between $13 and $28,000, which on the surface should have been in the $200 to $500 range. That is not a mild, insignificant difference. That is quite a substantial observation.

What did you do with his letter? First of all, do you know what General Dynamics did with his letter?

General **Monahan**. Yes, they withdrew their proposal, the pricing they had submitted to us. Is that a letter in April 1983, Mr. Bryant?

Mr. **Bryant**. April 1983, yes.

General **MONAHAN**. It should be the same one that I am speaking of in which he informed General Dynamics that in the opinion of the Air Force that those prices were too high. That is the vehicle he used to do that.

On the basis of that, General Dynamics reacted and withdrew the prices that they had offered to us. They went back and reproposed.

Mr. **BRYANT**. When was it that they did that?

General **MONAHAN**. Shortly thereafter, sometime there in 1983. But we informed them through Colonel Bodenhammer that we weren't going to negotiate on the basis of the proposal that we already had.

Mr. **BRYANT**. I didn't understand your words.

General **MONAHAN**. We informed the contractor through the letter that we were not going to complete the negotiation on the basis of the proposal we had at that time. So, it was on that basis that General Dynamics withdrew their proposal.

It was because of that action that they withdrew the proposal and what happened here is that the—what we thought to be prices higher than they should have been were discovered by Air Force employees, at a fairly low level, the people that are paid to catch those things did indeed catch them.

Mr. **BRYANT**. Colonel Bodenhammer says that he was not supported by the Air Force in these observations, and that it was not until the Senate began poking around in your business that you finally acted on this.

What do you say to that?

General **MONAHAN**. I never talked to Colonel Bodenhammer about that.

Mr. **BRYANT**. Mr. Quicksall, could you come forward? Could you tell us what you found regarding this chain of events that I have just asked about?

Mr. **QUICKSALL**. Yes, sir, if I tracked the chain of events correctly, the Bodenhammer letter was issued in April 1983, and suggested the items should cost only a few hundred dollars.

Shortly after that, in, I think, the summer of 1983, the proposals were revised, the hearings took place about that same time. I don't recall any other events.

Mr. **BRYANT**. Senate investigators showed up there in the summer of 1983, didn't they?

Mr. **QUICKSALL**. In July, as I recall, yes, sir.

Mr. **BRYANT**. And after that, everybody began hopping?

Mr. **QUICKSALL**. Yes, sir.

Mr. **BRYANT**. Mr. Chairman, I wonder if we could swear in Ms. Linda Talbot.

Mr. **WYDEN**. I think you are aware of the rules of the Subcommittee. Do you have any objection to being sworn?

Ms. **TALBOT**. No.

[Witness sworn.]

Mr. **WYDEN**. The gentleman from Texas is recognized.

Mr. **BRYANT**. Would you state your full name?

TESTIMONY OF LINDA TALBOT, CHAIRMAN, SERD COMMITTEE, OGDEN AIR LOGISTICS CENTER, HILL AIR FORCE BASE, UT

Ms. TALBOT. Linda Talbot.

Mr. BRYANT. What is your occupation?

Ms. TALBOT. I work for Hill Air Force Base now. I work with the FMS program, but I used to work with the SERD's, but don't anymore.

Mr. BRYANT. What work do you do now?

Ms. TALBOT. I work with Belgium on the F-16 acquisition.

Mr. BRYANT. What kind of a job do you have?

Ms. TALBOT. When they order items, I go in and if there is a problem on support equipment, I go in and find the problem and help correct it so they can get their items that they need.

Mr. BRYANT. You mean you fix the equipment?

Ms. TALBOT. No; I handle problems that come up with the items that they order.

Mr. BRYANT. You mean that the Air Force orders?

Ms. TALBOT. No; Belgium.

Mr. BRYANT. Belgium?

Ms. TALBOT. I did work on the SERD's but I don't any more.

Mr. BRYANT. I want to ask you what you do now because I want to determine what work you are trained to do.

Ms. TALBOT. I work with Belgium on the F–16, country manager for Belgium.

Mr. BRYANT. Are you an employee of the Air Force?

Ms. TALBOT. Yes.

Mr. BRYANT. And you work with Belgium as they purchase aircraft from the United States?

Ms. TALBOT. Support equipment, yes.

Mr. BRYANT. When they can't find a piece of equipment they ordered you go find out where it is?

Ms. TALBOT. They order them and if there is a problem getting the item they ordered, maybe an error in the part number or maybe there is a reason why there is a backlog, I just find out what the problem is so that they can order it.

Mr. BRYANT. Have you attended college?

Ms. TALBOT. Some.

Mr. BRYANT. You have not graduated?

Ms. TALBOT. No.

Mr. BRYANT. Are you trained specifically in a particular area? Do you have any kind of a vocational degree or has the Air Force trained you?

Ms. TALBOT. I have on the job training.

Mr. BRYANT. And you have been a civilian employee of the Air Force for all these years; is that right?

Ms. TALBOT. Yes.

Mr. BRYANT. Now, you were the Chairman of the Support Equipment Recommendations Data Review Committee in Ogden, UT, in July 1982; is that correct?

Ms. TALBOT. Yes, sir.

Mr. BRYANT. You reviewed the support equipment recommendation that was submitted by General Dynamics for tools to repair the radar antenna.

Ms. **Talbot**. Yes, sir.

Mr. **Bryant**. Is that correct; what we have been talking about here today?

Ms. **Talbot**. Yes, sir.

Mr. **Bryant**. You signed documents Linda Kennon, your name at that time?

Ms. **Talbot**. Yes.

Mr. **Bryant**. You were chairman of it; is that correct.

Ms. **Talbot**. Yes.

Mr. **Bryant**. Who else was on the committee? If you forget a few names, that is all right, but tell us in general who was on there and what kind of jobs they had?

Ms. **Talbot**. Like Mr. Sutherland and Mr. Graham, people that worked with the particular items, the technicians and equipment specialists are in on it—when we have a SERD review they come in and make their comments.

Mr. **Bryant**. Mr. Graham was not on the committee, was he?

Ms. **Talbot**. That was Shirley Brown and Blaine Harris who work in his office.

Mr. **Bryant**. Shirley Brown, what does she do? What is her job?

Ms. **Talbot**. They are technicians.

Mr. **Bryant**. They repair equipment?

Ms. **Talbot**. No, they don't. She is a planner.

Mr. **Bryant**. Planner? I am talking about back in 1982, what did she do?

Ms. **Talbot**. They work in maintenance and they work in the offices.

Mr. **Bryant**. She is—is she a typist?

Ms. **Talbot**. No. She is a material planner.

Mr. **Bryant**. Material planner.

Ms. **Talbot**. Engineering material planner.

Mr. **Bryant**. What is the end result of her job? What does she do or come out with? What does she plan?

Ms. **Talbot**. Well, when the SERD's come in I would process them and send them to the appropriate people who needed to look at them and look to see if these items were applicable and if they needed them and if they would put their comments on them and send them back to me.

Mr. **Bryant**. You basically handled the paperwork that came back in?

Ms. **Talbot**. Yes.

Mr. **Bryant**. And kept it compiled; is that right?

Ms. **Talbot**. Yes.

Mr. **Bryant**. You are not an expert with regard to defense material, right?

Ms. **Talbot**. No, sir.

Mr. **Bryant**. You don't have an opinion one way or the other as to whether——

Ms. **Talbot**. No, sir.

Mr. **Bryant**. Whether a particular part is needed or not or costs too much or not?

Ms. **Talbot**. No; I take the SERD's to the people who do have that knowledge and skills and authority that I do not have.

Mr. **Bryant**. You were chairman of the SERD Review Committee?

Mr. **Talbot**. That is because I processed the SERD's. The SERD's come in to me and I take the SERD's to the appropriate people, maybe Mr. Sutherland or Mr. Graham, these people take them and they are the ones who sign them and make their comments and agree or disagree. I compile the information.

Mr. **Bryant**. Tell me again, who was it that was on the SERD Committee. Mr. Graham, I think, was not on there.

Ms. **Talbot**. No, the people from his office, other people from his office were on it.

Mr. **Bryant**. And——

Ms. **Talbot**. Wayne Walker, and—Kent Sutherland.

Mr. **Bryant**. That is two, were there others?

Ms. **Talbot**. Blaine Harris and Shirley Brown, I mentioned them. They are from the maintenance side. They work in the same area that Mr. Graham does.

Mr. **Bryant**. Well, your committee approved the contract recommendation for support equipment; is that correct?

Ms. **Talbot**. Right.

Mr. **Bryant**. Now, did you sign something that said, "As chairman of this committee, we hereby approve this purchase. We hereby approve this particular plan for what we should buy?"

Ms. **Talbot**. There is not a statement on the SERD's that says that. The people involved make their comments on there and there is a block on there, everybody who attends this review signs it. That is what the signatures are of the people involved.

Mr. **Bryant**. In the case before us now, were you aware that you were approving the purchase of newly developed tools that already existed?

Ms. **Talbot**. Not me, no, that is not my job.

Mr. **Bryant**. Who did you rely upon mostly in approving this recommendation to your committee?

Ms. **Talbot**. The equipment specialist and technicians.

Mr. **Bryant**. Who did they rely upon mostly?

Ms. **Talbot**. I am sorry, I don't know their jobs.

Mr. **Bryant**. Where did they get their information?

Ms. **Talbot**. I would imagine—I don't know. I don't think that—that is not my job to know their job. I just send them to them and they send me back their comments.

Mr. **Bryant**. And then what do you do with all these comments when you get them back?

Ms. **Talbot**. I compile them and send them to the appropriate offices that need this information. There are several different places they go.

Mr. **Bryant**. Well, is there ever a time when the committee has a meeting and signs something and says, OK, our committee recommends that we do this?

Ms. **Talbot**. They agree or disagree to the SERD, the item on the SERD, they buy it or they don't buy it.

Mr. **Bryant**. OK. Then what do you do when you have a SERD that is agreed to, what do you do with it?

Ms. **Talbot**. They go back to Wright Patterson, they go to their people. Whether approved or not they go to the same people.

Mr. **Bryant**. I am sorry, I just don't understand that. Say that again. Who gets that SERD when you say, OK, let's buy it, who gets it?

Ms. **Talbot**. There are several people that get it. There are people at Wright Patterson, the SPO people get it, Battle Creek get it, cataloging, the equipment specialist, technicians, several people involved would get it.

Mr. **Bryant**. These people on the SERD Committee, if one of them didn't concur in the recommendation, what would happen?

Ms. **Talbot**. Just one?

Mr. **Bryant**. Yes.

Ms. **Talbot**. Well, usually if one didn't agree and gave their reasons it was usually a unanimous thing.

Mr. **Bryant**. But if somebody didn't agree what would happen to it?

Ms. **Talbot**. Well, it would still get sent back to the same offices and then——

Mr. **Bryant**. Would you record it?

Ms. **Talbot**. Yes.

Mr. **Bryant**. And so whoever you sent it to got it, it would be reflected on there that someone disagreed; is that right?

Ms. **Talbot**. Yes.

Mr. **Bryant**. Did Curtis Dempsey, a tool specialist from Warner Robbins Air Logistic, not concur with General Dynamics recommendation for the allen wrench?

Ms. **Talbot**. I am not—I remember him disagreeing on one of the SERD's but I don't remember which one. But there was one.

Mr. **Bryant**. The GAO indicated to us that in their interview with you——

Ms. **Talbot**. They showed me one but I can't remember the exact SERD. They showed me one that came back from Warner Robbins with Mr. Dempsey's nonconcurrence.

Mr. **Bryant**. Why did the committee concur in the recommendations for the allen wrench after Mr. Dempsey pointed out that the commercial allen wrenches stocked by GSA could be modified?

Ms. **Talbot**. I can't answer that. That is back in 1982.

Mr. **Bryant**. Let me ask you, could you have answered it back then, do you think?

Ms. **Talbot**. Yes.

Mr. **Bryant**. OK.

Ms. **Talbot**. When we have our SERD review they gave their comments.

Mr. **Bryant**. You would have had to look at everybody elses comment, right?

Ms. **Talbot**. Right.

Mr. **Bryant**. You wouldn't have had an opinion yourself?

Ms. **Talbot**. No.

Mr. **Bryant**. But you are chairman of the committee?

Ms. **Talbot**. Right.

Mr. **Bryant**. And in practice the committee pretty much agrees with all of the contracts recommendations; isn't that right?

Ms. **Talbot**. No; they put their own comments what they feel on there. If one agrees then they say so and if another one does and all the comments are compiled.

Mr. **Bryant**. Do you recall very many times when they didn't agree with the contractor's recommendations?

Ms. **Talbot**. Yes.

Mr. **Bryant**. You do?

Ms. **Talbot**. Yes.

Mr. **Bryant**. Well, where do they get their information about whether or not to agree? Where do they go for information?

Ms. **Talbot**. Well, I really can't answer that.

Mr. **Bryant**. I see.

Well, let me observe with all due respect to you, I think that your title as chairman of the Support Equipment Recommendation Data Review Committee was cooked up by somebody up above who didn't really want to have a support equipment recommendation data review committee because it is clear you have been put in a position with your not——

Ms. **Talbot**. But it is not my job. My job is to get the SERD, they are mailed to me from General Dynamics, I send those SERD's to the appropriate people. I have no authority.

Mr. **Bryant**. I agree.

Ms. **Talbot**. All I do is process paperwork, nothing more.

Mr. **Bryant**. Thank you.

You made my point for me perfectly well.

Mr. **Wyden**. I thank the gentleman from Texas.

Let's go back to the area that we started. Mr. Robert Smith, you were aware that Westinghouse had repaired the radar antenna for the Air Force for the past 5 years.

Mr. **Robert Smith**. Yes, sir.

Mr. **Wyden**. And you were aware that Westinghouse had tools to repair the antenna?

Mr. **Robert Smith**. Yes, sir.

Mr. **Wyden**. And you were aware that Westinghouse was repairing the radar at several locations and had multiple sets of tools?

Mr. **Robert Smith**. Yes, sir.

Mr. **Wyden**. What were these locations?

Mr. **Robert Smith**. The only one I am aware of is Fort Worth, and the Westinghouse plant.

Mr. **Wyden**. What about Europe?

Mr. **Robert Smith**. Yes, sir, there are some there, I am told.

Mr. **Wyden**. Did the Air Force pay for these multiple sets of tools originally developed by Westinghouse and used during these 5 years?

Mr. **Robert Smith**. I don't know.

Mr. **Wyden**. They did; is that correct?

Mr. **Robert Smith**. I have no knowledge of that.

Mr. **Wyden**. Did you take it out of your own pocket? That doesn't sound plausible. Would Westinghouse have taken it out of their own pocket?

Mr. **Robert Smith**. I don't know.

Mr. **Wyden**. Were you aware that Westinghouse had drawings in order to reproduce these multiple sets of tools?

Mr. **Robert Smith**. We were told at the time that drawings did not exist.

Mr. **Wyden**. Did you ask Westinghouse if they had drawings for these items?

Mr. **ROBERT SMITH**. Our technical publications people did, yes, during the validation.

Mr. **WYDEN**. What did they say? Did Westinghouse say there were drawings or deny there were drawings? What was said?

Mr. **ROBERT SMITH**. They said there were no drawings.

Mr. **WYDEN**. Mr. Shull, did Westinghouse have drawings of these tools?

Mr. **SHULL**. We had shop tooling drawings.

Mr. **WYDEN**. Pardon me?

Mr. **SHULL**. We had shop tooling drawings, sketches.

Mr. **WYDEN**. What is the difference again between a sketch and a drawing?

Mr. **SHULL**. A sketch is not updated after it is first drawn. We make the tool, that sketch is never updated.

Mr. **WYDEN**. How do you reproduce so many sets of them then?

Mr. **SHULL**. We build them from the drawing as best we can, we get with the technicians using them and made necessary modifications. We check them out before we send them to one of our field sites.

Mr. **WYDEN**. If Westinghouse could develop multiple sets of tools from these so-called sketches and then repair over 2,200 radar systems surely the Air Force could have used these same drawings to reproduce the tools.

Mr. **SHULL**. The drawings are not controlled. They do not meet the military requirements for the drawings or the testing to introduce them into the U.S. inventory.

Mr. **WYDEN**. But it could be done, couldn't it?

Mr. **SHULL**. Not to the specifications that we are controlled by.

Mr. **WYDEN**. Well, you developed multiple sets of tools from the so-called sketches; you repaired over 2,200 radar systems. Surely the Air Force could have used the same drawings to reproduce tools.

Mr. **HARRY SMITH**. May I interject?

Mr. **WYDEN**. Please.

Mr. **HARRY SMITH**. I think the fundamental problem is in our view—and this can be confirmed—it is not possible to introduce a tool into a piece of support equipment or tool into the inventory without following this SERD process. So no matter how close they are, you still have to go through the process to give it this pedigree that you keep talking about. So if we had had the requirement to use these tools officially—and this is a DOD regulation. It goes back to the McNamara days actually.

Mr. **WYDEN**. Let's ask Mr. Graham if you would come forward. Do you use any tools that have not gone through the SERD process, Mr. Graham?

Mr. **GRAHAM**. No.

Mr. **WYDEN**. I thought you used a piece of wire that you had cut.

Mr. **GRAHAM**. I may have made one, but I did not use it.

Mr. **WYDEN**. But you could have used it?

Mr. **GRAHAM**. Yes.

Mr. **WYDEN**. Let me again ask Mr. Shull why would you ever need to distinguish between a drawing or sketch for a 3-inch piece of wire for the alignment pin or a seven-sixteenths hex wrench for the Air Force to reproduce these items?

Mr. **Shull**. I am sorry; I did not understand your question.

Mr. **Wyden**. Why would you ever need to distinguish between a drawing or a sketch for a 3-inch piece of wire or a seven-sixteenths hex wrench for the Air Force to reproduce them?

Mr. **Cook**. Again, the concentration seems to be on the hardware portion of it and in all three of the opening statements, as has been brought out, there is one heck of a lot more than just hardware involved here. I think it was brought out in Mr. Wood's comments and Mr. Smith's comments and in the Air Force's comments.

Mr. **Wyden**. Well, what was the Westinghouse cost for the first set of tools?

Mr. **Cook**. We do not have an accounting of those costs.

Mr. **Wyden**. Make an estimate.

Mr. **Cook**. I have no idea.

Mr. **Wyden**. You must have some idea. You must have some kind of inclination. This has been an important contract.

Mr. **Cook**. I have no idea. We were not required to control those costs at that level, and I really do not have any feel for that.

Mr. **Harry Smith**. You see, they are aggregated in total tooling costs, so they are an insignificant amount of our total tooling costs.

Mr. **Wyden**. Mr. Robert Smith, were you aware that these originally developed Westinghouse tools had part numbers?

Mr. **Robert Smith**. At that time the only thing I saw were the SERDs.

Mr. **Wyden**. So you were aware at some point?

Mr. **Robert Smith**. The first time——

Mr. **Wyden**. At that point you were not, but you were aware later?

Mr. **Robert Smith**. Yes, about 2 weeks ago.

Mr. **Wyden**. Mr. Robert Smith again. An August 1981 memorandum indicates some of the Westinghouse tools had part numbers. In fact, GAO has determined that almost all of them had part numbers. Is it not obvious that if a tool has a part number then it has to have a drawing?

Mr. **Robert Smith**. No, sir.

Mr. **Wyden**. It sure looks to me like there is a game plan to change part numbers and double bill the Government. Is it not General Dynamics' responsibility to take steps to find out if there are drawings?

Mr. **Robert Smith**. The question asked if there were drawings, and we were told there were none.

Mr. **Wyden**. Were you not the least suspicious when multiple sets of tools with part numbers existed at the same time Westinghouse told you that no drawings existed?

Mr. **Robert Smith**. Say that again, please.

Mr. **Wyden**. Were you not a little bit suspicious when there were multiple sets of tools with part numbers in existence and at the same time Westinghouse has told you that no drawings existed?

Mr. **Robert Smith**. I was not aware of the part number at that time.

Mr. **Wyden**. I think any reasonable person would have been suspicious at that point. It is an August 1981 memo that goes through this as well.

[The following document was submitted:]

EXHIBIT 1

WESTINGHOUSE PLOT TO SWITCH PART NUMBERS TO COVER UP EXISTENCE OF DRAWINGS AND WORKABLE TOOLS

In April 1981, General Dynamics discovered Westinghouse was using company tools to disassemble and assemble the radar antenna. In August 1981, General Dynamics became aware that some of the original Westinghouse support equipment items did in fact have part numbers. In November 1981, Westinghouse recommended the tools to General Dynamics; and General Dynamics, in turn, recommended the tools to the Air Force. The records show that the tools were given new numbers when they were recommended to the Air Force.

Tool Names	Tool Numbers Recorded in April 1981	Tool Numbers Recommended in November 1981
Pulley Puller	5K646R501TXC	3426B73G01
Clamp Alignment Tool	646R498TXA	3426B74G01
Set Indicator (AZ)	682R704TXA	3426B75G01
Set Indicator (EL)	682R697TXA	3426B76G01
Motor Puller (AZ)	646R707PTXA	3426B77G01
Motor Puller (EL)	646R708PTXA	3426B78G01
Allen Wrench (Modified)	Unknown	3426B84G01
Height Guage	643R508TXA	3426B79G01
Non-Metalic Tool	681R282TXB	3426B86G01
Alignment Pins	Unknown (0.063 X 3")	3426B85G01

(Not all tools were identified in April 1981.)

Mr. **Robert Smith**. I did not see that memo in August 1981.

Mr. **Wyden**. It was very early in the process as well.

General Dynamics' memo, August 27, 1981, from R. D. Honea, if I pronounce it right, to W.P. Cahill, C-a-h-i-l-l. Do you know those people?

Mr. **Robert Smith**. Yes.

Mr. **Wyden**. They did not tell you that there were part numbers?

Mr. **Robert Smith**. No.

Mr. **Wyden**. Mr. Wood, do you feel you have fulfilled your contractual obligations as the prime contractor to oversee and manage the subcontractor, Westinghouse?

Mr. **Wood**. On balance, yes.

Mr. **Wyden**. Do you, in effect, always place your total trust in all the subcontractors?

Mr. **Wood**. Approximately 65 percent of the cost of an F-16 is done outside of General Dynamics, and I would suggest to you, gentlemen, yes, we do hopefully in the process of selecting those vendors place a great deal of trust in their performance. Yes, we do. We try to and this maybe sounds too flippant—we cannot possibly micro-manage, and I know I am leading myself into a trap here, because the costs would be prohibitive if we really did micromanage. We cannot do that.

Mr. **Wyden**. We are not interested in micro-management at all, Mr. Wood. What we are interested in is internal safeguards and we like to know what the incentive is for General Dynamics to hold down the price of Westinghouse support equipment on an unpriced order like this one.

Mr. **Wood**. If I may, we did not get a chance to go into at least a part of it that I wanted to talk about earlier, but let me just briefly say we are trying to institutionalize some of our procedures that will improve the process we have been living with for a number of years. For example, we are trying very hard—we have a committee to simplify test equipment. Let's get involved in the front end so we make the decisions early on, not only by ourselves, but also in connection with the vendors.

Second, in those areas where there is a possibility there will be larger numbers involved, let's buy the larger quantity, not buy the onesies and twosies which make the costs look absolutely ridiculous.

A third thing we are trying to do is in those instances after we have designed the product or after the vendor has designed the product, we are suggesting to our customer to break it out, go out and buy it yourself, go out and buy competitively. We have done this very, very often. It's available for the record. And so we are trying.

Mr. **Wyden**. I appreciate you are trying, but I still do not see what incentive there is for General Dynamics to hold down the prices of these subcontracts.

Mr. **Wood**. I used to talk about this when I was maybe a little more younger and maybe not quite as careful, but let me not be so careful for a moment.

I believe very strongly, and I have been giving this speech for the last 15 years, that we compete a number of times for a system. We compete with the budget process, first of all, to get a program through. Once a program is through, we compete annually to keep that program alive, and then we compete that 65 percent that I talk about and we compete technically. As long as we do not perform, we are placing that system in jeopardy, thereby placing ourselves in general or difficulty, and we have a lot of motivation to try to do the best possible job we can.

Mr. **Bryant**. Will the gentleman yield?

Mr. **Wyden**. Be happy to.

Mr. **Bryant**. I would like to ask you, Mr. Wood, who is it you compete with to keep the program alive?

Mr. **Wood**. Who are the people? I am sorry. I missed the first part.

Mr. **Bryant**. You say we compete at a number of stations, to get the program going, then compete to keep the program alive. With whom do you compete to get the program going?

Mr. **Wood**. We compete with almost every other company that is involved in the aerospace business that have a system they too—the Government has decided they would like to have. That is a competition for dollars, Mr. Bryant, every year which really is very real.

Mr. **Bryant**. How much of your work is subject to competition?

Mr. **Wood**. I'll have to go back a little bit and start you. We competed for the F-16. Believe me we competed hard with Northrop for the F-16. We did not compete for the M-1 because we acquired the tank operation when it was in being. We did compete for practically every cruise missile program that we have, either at Pomona or at our Convair operation.

Mr. **Bryant**. Then you describe how you compete to keep the program alive.

Mr. **Wood**. Every year it's based on performance to try to keep the program within cost, to try to do the technical job, to try to make sure that we perform in such a fashion and provide a product that our customer wants to their satisfication and in the best interests of our country.

Mr. **Bryant**. Who is it you are competing against? It is these fellows down here, is it not?

Mr. **Wood**. No, sir. I think we spend more time—I am not being flippant, so I do not mean to be offensive. We spend more time competing here than we do there.

Mr. **Bryant**. You never lose.

Mr. **Wood**. Sorry, we do, sir. Yes, sir, we do lose.

Mr. **Bryant**. Tell me the last time you lost a big one.

Mr. **Wood**. I can tell you—let me tell you off camera, if I may. The fact is I can tell you, but I would rather not do it on camera.

Mr. **Bryant**. Can you tell me why?

Mr. **Wood**. Well——

Mr. **Bryant**. I would like to know the last time you lost a bid. You guys never lose, General Dynamics, and to some extent Westinghouse and in other cases Pratt & Whitney and others. You manage the Defense Department; it is not them. It is obvious from the testimony today you guys manage our Defense Department.

Mr. **Wood**. If I may, let me give you an example of what I had in mind. It's a program I cannot talk about. That is what I had in my mind and that was my reason. We felt that we would under normal circumstances might have been a player in the small mobile, but we are not a player in small mobile and there were some four or five contracts awarded and we did not get one of those. No problem with that. That is OK.

But there are a number of other programs.

Mr. SIKORSKI. You almost lost the Trident, but the Secretary of the Navy changed his mind after Ed Meese and the White House got involved and Mr Sawyer, who was then Assistant Secretary of the Navy and now executive vice president of General Dynamics, cut a deal in a limousine. But I have a question of the gentleman, if you will yield to me on this.

Mr. WYDEN. Be happy to yield.

Mr. SIKORSKI. On the micromanagement issue that you were concerned about, Mr. Smith, why did you increase your price for the—this is for Mr. Smith from Westinghouse, and I will get back to Mr. Wood—why did you increase your price for the pulley puller from $3,102 in July 1982 to $6,005 in November of that same year?

Mr. HARRY SMITH. I would like to defer that question to our contracts manager here.

Mr. COOK. I do not have an answer for that, but we will check and submit it to you.

[The information follows:]

The price change referred to in this question resulted from General Dynamics' Request for Proposal No. 231.112, which requested prices for quantities of the various items of support equipment (including the pulley puller) that were different from the quantities specified in the July, 1982 Westinghouse proposal. The quick response requested in this Request for Proposal, necessitated that Westinghouse use the pricing information assembled in support of the July, 1982 proposal as the basis for preparing the November, 1982 "not-to-exceed" prices. The person preparing the new estimated prices misinterpreted a number contained in the July, 1982 pricing information and, as a result, the nonrecurring costs of the pulley puller were overstated in the November, 1982 "not-to-exceed" prices.

However, it is important to note that this mis-interpretation had no effect on the ultimate price of the pulley puller, because all "not-to-exceed" price proposals were superseded by the firm fixed price proposal subsequently submitted by Westinghouse. The firm fixed price proposal was prepared using a "bottoms up" pricing technique, which did not in any way use or depend on either the misinterpreted number or the overstated nonrecurring costs referred to above.

Mr. SIKORSKI. The Azimuth motor puller increased from $6,970, $6,970 to $17,863. The motor brush assembly tool increased from $3,188 to $6,009 and on and on. The first proposal, not to exceed the price proposal presented by General Dynamics totaled for the maintenance stand was $104,251. These were effective until November 9, 1982.

Then the second proposals from Westinghouse came in. The maintenance stands jumped up to $229,000. As I said, the pulley puller went from $3,100 to a little over $6,000, the motor puller price from $6,900 to over $17,600 and on and on. I looked at every one of these, and they all jumped up in price.

Mr. HARRY SMITH. Excuse me. What is the source? You are reading numbers there. Can you identify the source?

Mr. SIKORSKI. These are from your proposal dated July 15, 1982. You provided two NTE, not to exceed price proposals for the 14 small tools, not including the RF motor. The first is July 15 and effective to October 31, 1982. The second NTE, not to exceed, price was dated November 9, 1982, and was to expire December 31, 1982.

The second proposal was accepted by General Dynamics. I would not consider this a case of micromanagement. It is a case where you blew a lot smaller price, NTE price proposal, for these 14 tools. Mr. Wood.

Mr. WOOD. Would you like me to respond?

Mr. SIKORSKI. I would appreciate your concern for micromanagement in your earlier response. But who is looking out for the taxpayer? You have no incentives to pick the smaller price.

Mr. WOOD. Believe me, really we would have all the incentive——

Mr. SIKORSKI. Why? You get paid on the basis of price plus a profit.

Mr. WOOD. That may be true in some instances, because of the passage of time.

Mr. SIKORSKI. It is true in these instances.

Mr. WOOD. I would look to——

Mr. SIKORSKI. Is it true in these instances?

Mr. WOOD. No.

Mr. SIKORSKI. It is not?

Mr. WOOD. No.

Mr. SIKORSKI. Why?

Mr. WOOD. Because what you have, I think, are a list of prices that in and of themselves are not-to-exceed prices. The total is not to exceed, so I would have to examine with you the bottom line number for all items to see whether or not the cost increased.

Mr. WYDEN. If I might reclaim my time, this bottom line, Mr. Wood, is General Dynamics gets an automatic 13.5 percent profit plus substantial overhead charges on top of whatever Westinghouse attempts to charge the taxpayers. Is not that the bottom line?

Mr. WOOD. Yes; to a degree.

Mr. BRYANT. Mr. Chairman, if I might also observe——

Mr. WYDEN. I was yielding to the gentleman from Minnesota.

Mr. BRYANT. I wanted to observe they also don't bother to pay Federal income taxes and haven't for 10 years, so as you come up here and lobby us and spend money for your company, you don't contribute anything to the Federal budget; isn't that correct?

Mr. WOOD. No.

Mr. BRYANT. Explain to me how you contribute to the Federal budget when you don't pay any taxes.

Mr. WOOD. When you say "don't pay any taxes," you have to put a time frame on it. We are deferring taxes, I believe it is this year.

Mr. BRYANT. Have you paid taxes for the last 10 years?

Mr. WOOD. I can't answer that. I don't know.

Mr. BRYANT. The fact that it is in doubt is answer enough.

Mr. WYDEN. I will continue to yield to the gentleman from Minnesota.

Mr. SIKORSKI. Mr. Wood, you said two things that got you out of answering the question, and neither of them were correct. One is you have said that you don't get the price plus a profit on this and the answer is you do.

Mr. WOOD. I didn't say that. I said yes.

Mr. SIKORSKI. To Mr. Wyden, but to me you said no.

The other thing you said was there is a difference in the total overall, not-to-exceed price on these figures, and there isn't.

Mr. **Wood**. I didn't say that either. I said I would have to go over them and see what the bottom line was.

Mr. **Sikorski**. The bottom line was that the second proposal was much more expensive than the first proposal, so we are back to this micromanagement response you gave earlier.

Mr. **Wood**. The reason I am asking the question we are talking about the bottom line and I suspect, I don't know not having examined what you have there, we, to my knowledge, have never had the experience of giving the customer a not-to-exceed price and then going back unless there is a scope change and getting more money, so that is why I would have to say I would have to examine that.

Mr. **Sikorski**. You had a not-to-exceed price on 14 small tools, the first dated July 15, 1982. It expired on October 31, significantly lower than the not-to-exceed price. This is from Westinghouse, your subcontractor, and that was the context of the original question.

You got a second one dated November 9 that was to expire December 31, 1982, that is the one you chose, to the great detriment of the taxpayers, because they had to pay more. General Dynamics got more by virtue of this process and the taxpayers paid for it because of this process.

I want to comment, Mr. Chairman, that we had a big chart. We began this with two big chart presentations about the paperwork and the system and how it was designed to assure that the tools are effective, the tools are good, they are needed and that the system is cost efficient to the extent that it can be. But that system costs the taxpayers too much money.

Well, I submit that we have an instance where the system wasn't observed and the taxpayers didn't save any money. I would suggest that the Department of the Air Force was accurate when they submitted their witness list appearing before the subcommittee when they said the subject is the, "collapse of the defense acquisition system spare parts F-16 support equipment." It did collapse. It collapsed at the Air Force and it collapsed with the subcontractor and the contractor.

I thank the chairman for yielding.

Mr. **Wyden**. I only want to return to this point very briefly. We have established in response to my last question, Mr. Wood, that General Dynamics gets an automatic 13.5 percent profit, plus substantial overhead charges on top of whatever Westinghouse tries to charge. General Dynamics made, as a result of using this system, over a $1,000 profit on the $8,800 pulley puller on top of the $638 profit that Westinghouse made. What really concerns me at this point is that the Air Force alone has $10 billion outstanding of these kinds of unpriced orders and that the figure is doubling in one year. I can assure you that this Subcommittee is going to do everything it can to turn this situation around.

One last question, and then I recognize the gentleman from Texas.

Mr. Yates, I asked Mr. Wood what incentive there was for General Dynamics to hold down the price of Westinghouse support equipment, for example, in the unpriced order. What do you think the incentives are in the current system, the one that you defended so vigorously up there at the chart? What do you think the incentives are in the current system for General Dynamics to try to hold down the costs of the Westinghouse support equipment?

General **Yates**. Well, to begin with, General Dynamics is in a broad scale on an incentive contract to the Air Force. General Dynamics does not make a larger percentage of profit as the costs of the contract go up. They make a smaller percentage of profit. So that is their first broad-scale incentive.

Mr. **Wyden**. On an unpriced order?

General **Yates**. Yes, sir. When it is definitized——

Mr **Wyden**. But before it is definitized, there aren't any incentives?

General **Yates**. Before an unpriced order is definitized, I think there is not much incentive; that is correct.

Mr. **Wyden**. That is all we are asking, and I certainly agree with you.

The gentleman from Texas.

Mr **Bryant**. I would like to ask Mr. Shull how General Dynamics managed to have 359 engineering hours for work relating to the Westinghouse items. How is that possible?

Mr. **Shull**. I can't speak for General Dynamics.

Mr **Bryant**. Aren't the Westinghouse items usable when they are provided to General Dynamics?

Mr. **Cook**. If they have passed all the requirements that are in the contract; that is correct.

Mr **Bryant**. General Dynamics does not have to do further work to get the Westinghouse equipment to work?

Mr. **Cook**. We don't know what the requirements under contract from the Air Force to General Dynamics are.

Mr. **Bryant**. Are the items that you provide them usable?

Mr. **Cook**. The items meet the contractual requirements that we have with General Dynamics.

Mr. **Bryant**. Mr. Wood, did you have anything on the contracts that would allow them to provide you with something that wasn't usable?

Mr. **Wood**. No.

If I could expand, we would—first of all, we took the 359 hours out of the system. Let's set that aside for the moment. We have a number of those items that are on those display boards that we have to fill. An example, any item that flows through our material operation, it has to pick up part of the cost, any of the paperwork or software associated with that. Although they might deliver to us a fully operable piece of equiment if it comes through our house, it is going to pick up some of those things. It is terrible, but true.

Mr. **Bryant**. What can we do about it?

Mr. **Wood**. I would like to change the situation. When I said Government is not the most efficient solution, I was saying together we have to find ways to take out of the system some of these kinds of things.

Mr. **Bryant**. How did the 359 hours get there in this case?

Mr. **Wood**. I can't tell you that. The guys told me and I forgot. Can I submit that to you, please?

Mr. **Bryant**. I wish you would.

Thank you, Mr. Chairman.

Mr. **Wyden**. Unless any of our other witnesses have further comments, let me say that it is certainly the intention of the subcommittee to proceed vigorously with its investigation and the testimony that we have heard.

Today certainly can't make taxpayers feel any better with respect to the situation of making sure they get a buck's worth of value for their defense dollar.

The record will stay open for additional written responses that were required during the course of the hearing and if our witnesses have further comments.

Mr. Smith.

Mr. **Harry Smith**. I would not like to leave the impression that there was anyting in any way wrong with the use of two-part numbers.

Mr. **Wyden**. I am sorry; I couldn't hear that.

Mr. **Harry Smith**. I would not like to leave the hearing with any impression that there was anything wrong or amiss in the use of two sets of part numbers The first set of part numbers, whether they were drawings or not, were internal Westinghouse part numbers. In order to give this a SERD number and a pedigree, the Federal stock numbering system requires a different number. There is nothing—there is nothing of an improper nature about using, having two sets of part numbers.

Mr. **Wyden**. Mr. Smith, your comments are welcomed, but certainly it is the feeling of the subcommittee that as a simple matter of management integrity, it is important to point out these kinds of problems to the Government.

Do any other witnesses have any further comments?

The subcommittee is adjourned.

[Whereupon, at 3:40 p.m., the subcommittee adjourned, to reconvene at the call of the Chair.]

FEDERAL SECURITIES LAWS AND DEFENSE CONTRACTING

Questionable Use of Foreign Consultants

WEDNESDAY, OCTOBER 2, 1985

House of Representatives,
Committee on Energy and Commerce,
Subcommittee on Oversight and Investigations,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2123, Rayburn House Office Building, Hon. John D. Dingell (chairman) presiding.

Mr. Dingell. The subcommittee will come to order.

This morning the subcommittee proceeds under rules 10 and 11 of the House of Representatives which assigned to this subcommittee and all subcommittees of the House the responsibility for oversight over laws and behavior of persons subject to those laws under the jurisdiction of several committees.

The Energy and Commerce Committee has responsibility for the Federal securities laws and, therefore, for the Federal Securities and Exchange Commission and persons responsible thereto.

The committee and its Subcommittee on Oversight and Investigations are charged specifically under the rules with reviewing on a continuing basis the administration of those laws to ensure that they are both adequate and that they are adequately and properly enforced.

The stability of the Nation's financial markets depends upon the American investor believing in the fundamental value of companies whose securities are traded in these markets. Incomplete, inaccurate, and misleading information or information available only to insiders destroys the confidence of investors and ultimately the effectiveness of the Nation's capital markets. Investor confidence depends upon accurate and timely information, honest corporate management, and a stock market that is not rigged.

The subcommittee has maintained a continuing interest in how the Federal securities laws are being implemented. This includes the Federal accounting reports and material disclosures mandated by the Securities Exchange Act of 1934 and the Foreign Corrupt Practices Act, both of which matters are under the jurisdiction of this committee. Our inquiry into the accounting profession is, in part, a result of the concern of the committee that the disclosure system shall work and shall work properly according to law.

At the subcommittee's hearing on March 25, 1985, a number of questions were raised about the use by the General Dynamics Corp. of a foreign consultant in Korea, former Korean Air Force General E.Y. Yoon.

The committee was curious. What did General Yoon do for General Dynamics to warrant payments of over $2 million? Why did General Yoon take a $220,000 General Dynamics check from Seoul and deposit it in a Paris bank account? Did General Yoon make payments in violation of the Foreign Corrupt Practices Act to key Government officials in Korea or elsewhere?

What was the role of top General Dynamics management in retaining General Yoon, and what knowledge did they have of his activities? Indeed, what controls did they have over his activities?

Why was well over $1.5 million in General Dynamics consulting fees for General Yoon charged to the taxpayers in violation of Defense Department regulations?

The committee is, of course, curious about whether those funds have been returned to the Defense Department in appropriate fashion. Mr. P. Takis Veliotis, former member of the board of directors and executive vice president for international sales for General Dynamics, told the subcommittee staff that he was present at a meeting with Mr. Lewis and General Yoon. At that meeting, General Yoon asked for more money to cover certain obligations he said he had acquired in promoting the sale of F-16 aircraft and other weapons systems for General Dynamics in Korea.

General Dynamics provided additional funds to General Yoon in the form of a 5-year contract for $1.2 million. This occurred after the sale of the F-16. Mr. Veliotis has made the flat assertion that General Yoon paid Korean military and Government officials and claims to have evidence to support that claim. As yet, that information has not been supplied to this committee in the form of documentation.

As a result of further inquiry, however, the subcommittee learned that General Dynamics was not the only major defense contractor who dealt with General Yoon. The subcommittee found General Electric, United Technologies Corp., LTV, Martin-Marietta, and a number of German and Korean firms also retained General Yoon.

Shortly after the hearing of the subcommittee on March 25, the five American defense contractors terminated their arrangements with General Yoon. Perhaps this is laudable. The committee will inquire why.

In the mid-1970's a number of U.S. corporations, including various major defense contractors, were found guilty of paying off Government officials in a number of foreign countries, involving sales of weapons systems. In 1978 the Congress passed the Foreign Corrupt Practices Act, which prohibits such payments.

The Foreign Corrupt Practices Act makes payments to foreign officials illegal under certain circumstances. Corporate management is made responsible under the act if it knows or has reason to know of the illegal nature of the payments. To insure proper compliance with the act, specific accounting and bookkeeping practices are required. The committee will inquire as to whether these required practices are being carried forward in appropriate fashion.

At this time, the subcommittee is not claiming that any of the companies present today, or General Yoon, have violated the Foreign Corrupt Practices Act. The subcommittee is examining a set of transactions which, if done as Mr. Veliotis says they were done, could easily evade the act and probably violate the act.

The Committee on Energy and Commerce has been asked to change some of the provisions of the act. This particular Member of this committee has been sympathetic with the idea that perhaps changes should be made. One of the things that this committee today will inquire into is will, in fact, some change be either needed or appropriate in the statute? The committee may wish to clarify some of the accounting provisions of the act to avoid further problems.

The subcommittee has requested that the five companies involved supply all documents, evidence of all payments, and other records relative to their consulting relationship with General Yoon. All five companies have cooperated voluntarily with the subcommittee, for which the Chair wishes to commend them and express the appreciation of the committee. That is, indeed, an appropriate and proper fashion for our witnesses to have behaved. Martin-Marietta is still completing its submissions but has assured the subcommittee that it will comply fully with the request within the next week.

The subcommittee has also subpoenaed the records of a number of U.S. bank accounts of General Yoon that have been identified. Strange things have happened with payments to General Yoon. Most were deposited in General Yoon's U.S. bank accounts. In additional movements of money, General Yoon has either sent or personally delivered $2.5 million in these payments to a Paris bank account. One must inquire, why Paris? And what, perhaps, is the next step? Did General Yoon request payment outside Korea for purposes which would have raised a red flag both for management of the contractors and perhaps for the Korean Government?

The subcommittee has been in contact with the Department of Justice relative to General Yoon's bank accounts. The legal process for access to these records has been initiated, and the committee expects cooperation by the Department of Justice once that information has been made available.

The activities of General Yoon certainly raise some interesting issues. The first witness of the subcommittee this morning will be Mr. Bruce Chafin of the subcommittee staff, who will detail the subcommittee's interim findings.

The second witness was to have been General E.Y. Yoon, the president of Buyeon Company of Seoul, Korea. General Yoon was requested to appear voluntarily today. The subcommittee staff has been in contact with General Yoon on a number of occasions over the last 2 months in an effort to set up an interview. This effort has not, as of this moment, been successful.

Our panel will then include representatives of five major defense contractors who retained General Yoon as a consultant in Korea.

The Chair announces that our order of witnesses will be announced, and the Chair will recognize members for opening statements.

The gentleman from Oregon?

Mr. **Wyden**. Thank you very much, Mr. Chairman.

We are going to look this morning at a fascinating and highly questionable aspect of the way our major weapons producers conduct business in the lucrative overseas marketplace.

On March 25, at our hearing, I asked General Dynamics Chairman David Lewis about a 1975 internal General Dynamics memo concerning payments to foreign agents in connection with overseas arms sales.

The memo, which was written by Mr. A.M. Barton of General Dynamics is a veritable roadmap of how a company could funnel cash to foreign agents in a clandestine fashion, thereby permitting payments to be made to foreign officials in exchange for ensuring favorable consideration of proposed weapons sales.

Mr. Barton specifically mentions "front organizations" and "payments made through consulting agreements." He concludes that through creative use of these ploys, no one would be the wiser.

I think this is an important and remarkable document. Mr. Lewis denied at at that hearing that it reflects the overseas business practices of General Dynamics, and he also denied that General Dynamics ever engaged in illegal activity involving payments to foreign agents to, in effect, grease overseas sales.

Mr. Lewis has said that this is not the way General Dynamics does business overseas, but the evidence in the chain of events we will examine this morning makes such a claim increasingly hard to swallow.

The evidence indicates that General Yoon of the Buyeon Company—which I understand means, in Korean, "quick riches"—that General Yoon routed and rerouted huge sums of money around the globe with the speed and stealth of someone who has something to hide.

Millions of dollars in consulting fees traveled from the United States to Korea, back into the United States, and finally to Paris. On March 25, we knew of only a single General Dynamics payment to General Yoon, deposited in a Paris bank account. Now we have hard evidence that numerous payments and deposits mysteriously found their way to the same Paris bank.

The issue is, why on earth would payments made to a Korean consultant eventually wind up in Paris? A reasonable observer could easily conclude that it's because it is very difficult for either the U.S. Government or the Government of South Korea to find out what happens next.

In a sense, the subcommittee's investigation at this point ends in Paris. Although the Department of Justice has been asked to secure the Paris bank records, we don't have that piece of the jigsaw puzzle before us. And perhaps that was the whole idea from the start: just keep the money moving around so that its ultimate destination and ultimate purpose simply would never see the light of day.

The fact is, Mr. Chairman, the evidence we have up to this point raises many more questions than answers. I hope we can get some straightforward information from our witnesses today. And I want to applaud you, Mr. Chairman, for your determination to stay with this investigation as long as necessary to find the answers to the very serious questions that have been raised thus far.

Mr. **Dingell**. The Chair thanks the gentleman.

The gentleman from Minnesota.

Mr. **Sikorski**. I thank the chairman.

I want to commend you once again for your wisdom in continuing this indepth investigation. I want to compliment the staff, especially Mr. Chafin, for a thorough and professional investigation under tough circumstances and tight deadlines.

It is alarming enough that this subcommittee has identified a defense procurement system that is rotten to the core. But today's hearing goes beyond that. It takes us into the shadowy area of international payoffs, used apparently to satisfy some contractors' insatiable appetites for more and more sales. It suggests a taxpayer-financed money-laundering operation in which the American citizens are the ones taken to the cleaners, and it smacks of the kind of intrigue most frequently associated with organized crime or espionage.

It's not what we expect from those charged with protecting our national security. In fact, we have all the elements of a good spy story, at least a cheap thriller. We've got a Korean national and former Korean Air Force general with bank accounts all over the world, a mysterious unidentified woman receiving hundreds of thousands of dollars in a Paris bank account, a paper company titled "Quick Riches," our own State Department's inexplicable involvement with this Korean general and this company, millions of dollars flowing from five of America's biggest defense contractors, and charges from a fugitive and former inside man in one of these defense contracting firms that Korean officials were bribed with millions.

Well, I look forward to the testimony today and hope it will shed more light on this story. Unfortunately, it's not cheap, and it's not very thrilling.

But I again thank the chairman and commend him and the staff for their excellent work.

Mr. **Dingell**. The Chair thanks the gentleman.

The Chair recognizes the gentleman from Texas.

Mr. **Bryant**. Thank you, Mr. Chairman.

I also commend you for continuing to pursue this matter. I think it's very important and very much in the national interest that we do so.

I am concerned, in addition to the statements already made about the information we have received that the U.S. Embassy in Korea apparently recommended Mr. Yoon's company as a trade contact, then deny that they do that kind of thing, then, when shown the cables or the documents that would validate the assertion that they had done so, then said, "Well, this must be an unusual situation." Then following that, apparently, the staff found more information in Mr. Yoon's files than they got from the Department of State.

I think it would be valuable for the committee to bring those people forward as well at some time in the future. I think we deserve to give the companies that are here today a fair opportunity to explain their relationship with Mr. Yoon. Maybe we will find that the situation is not as bad as it appears on the surface.

I would have to say, however, that they would have to come forward with the most unusual and impressive statements to erase the impression of wrongdoing that surrounds the set of facts that we have before us at the present time.

I have no further statement.

Mr. DINGELL. The Chair recognizes the gentleman from Virginia.

Mr. BLILEY. I have no statement.

Mr. DINGELL. The Chair announces that our first witness is Bruce Chafin, from the staff on the Oversight and Investigations Subcommittee.

Mr. Chafin, I am sure you are familiar with the rules of the committee and the subcomittee practice that all witnesses will be sworn. Do you have any objection to being sworn as a witness?

The reporter does not have a copy of them, so you must say "Yes" or "No." You do not object?

Mr. CHAFIN. I do not object.

Mr. DINGELL. Do you desire to be accompanied by counsel in your appearance before the committee?

Mr. CHAFIN. No, thank you.

Mr. DINGELL. Copies of the rules of the committee and the subcommittee and the House are now available before you at the table.

If you will please raise your right hand.

[Witness sworn.]

Mr. DINGELL. You may consider yourself under oath. The Chair understands that you have a statement for the committee, and you are recognized for the purposes of giving that statement at this time.

TESTIMONY OF BRUCE F. CHAFIN, STAFF, SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

Mr. CHAFIN. Thank you, Mr. Chairman.

At this subcommittee's hearing on March 25, 1985, a number of questions were raised concerning the activities of a General Dynamics foreign consultant, retired Korean Major General Eung-Yul Yoon, and his company, the Buyeon Company, Ltd. Among the issues raised at that hearing were the nature of the consulting services provided by General Yoon and why a General Dynamics check for $220,000 physically delivered to Seoul has been deposited in a Paris bank account.

Subsequent to that hearing, Peter Stockton of the subcommittee staff and I interviewed P. Takis Veliotis, a former senior executive of General Dynamics, regarding General Yoon's activities involving General Dynamics.

Mr. Veliotis alleged that General Yoon was making payments to Korean officials on behalf of General Dynamics to win Korean Government contracts. Mr. Veliotis alleged further that the monies needed for these payments were part of the compensation General Dynamics paid General Yoon for his consulting services. In essence, Mr. Veliotis characterized the use of foreign consultants as a device frequently used to evade the Foreign Corrupt Practices Act. Mr. Veliotis claimed that on numerous occasions General Yoon attempted to extract more money from General Dynamics to meet his obligations and ultimately asked the company to help him get out of Korea.

In attempting to pursue these allegations, we discovered that General Yoon not only provided consulting services for General Dynamics, but provided services for four other major defense contractors: General Electric, United Technologies, LTV, and Martin-Marietta.

As embodied in one of the General Electric contracts with the company, Buyeon was to provide overall management, technical support, coordination, administration, and liaison services for General Electric in its program with the Korean Navy. The Buyeon Company is owned by six individuals, with General Yoon owning 52.65 percent. Attachment 1 lists Buyeon's involvement with the companies, as reported.

In addition, Figure 1 attached hereto, depicts the payments these five companies made to General Yoon during their involvement. It should be pointed out that all of these companies have now terminated their relationship with General Yoon. However, the terminations by General Dynamics, General Electric, United Technologies, and Martin-Marietta came shortly after this subcommittee's March 25 hearing.

As can be seen by figure 1, between 1973 and 1985, General Yoon collected in excess of $6.5 million from the five companies. In addition, LTV's payments to General Yoon began 3 years prior to the formation of his consulting firm, the Buyeon Company, Ltd. During this 3-year period, General Yoon was president of Korea Tacoma Marine Industries Company, Ltd.

In pursuing the payments with these companies, we learned that, as with the $220,000 check deposited in Paris, much of General Yoon's money was not deposited in Korea. In fact, we found many instances where checks sent to Korea were taken out of Korea for deposit in the United States or France.

In the General Dynamics case, payments originally made by wire transfer were changed to check payments which were negotiated outside of Korea. In addition, we found General Electric was wiring General Yoon's payments to the First City Bank of Dallas, TX, at his request.

On August 12, 1985, the subcommittee issued a subpoena to the First City Bank of Dallas. Upon examining the records, we learned that monies from not only General Electric but General Dynamics, LTV, and United Technologies flowed through the two First City Bank accounts. While funds from Martin-Marietta also went to Dallas, they were for expense reimbursement. The company's fee payments were sent to and negotiated in Korea.

The Dallas accounts, one in the name of General Yoon and the other in the name of Buyeon, accounted for more than $2 million in deposits of $10,000 or more. Figures 2 and 3 depict those deposits. In addition, many other checks from the companies in amounts less than $10,000 were deposited in Dallas.

General Yoon explains in company records the need to have payments made in the United States due to "the slowness and unreliability of the postal service between the United States and Korea." This justification becomes highly questionable when you consider

General Yoon deposited monies in Dallas that he had already received in Seoul.

Further, General Yoon deposited a check from George Durr, head of General Dynamics' Tokyo office, in a Dallas bank account that was written against the Chase Manhattan Bank in Seoul, Korea. This same Seoul bank happens to be one of the banks in which General Yoon maintains an account.

In addition to the monies not going to Korea, the monthly statements of the First City Bank accounts were not sent to Korea. General Yoon arranged to have the records of these deposits sent to a Ms. K. Bahk in France.

To ensure further that no records or information were sent to Korea relating to these transactions, General Yoon sent a telex—that's attachment 2 to the statement—to United Technologies requesting that they not only make their deposits in Dallas but that they "never advise or communicate to us on your payment status." Instead, he would "check them from bank statements."

I would like to point out and remind everyone that the bank statements were going to Paris, and so he's ultimately closed the circle and no information goes to Korea.

Although United Technologies officials questioned this request internally, they complied with General Yoon's wishes.

With regard to the withdrawals from the First City Bank of Dallas, it becomes apparent that this was only the first clearing point for General Yoon's money. Figures 4 and 5 refer to the transfers of money out of these two accounts. Until this year, the bulk of the money either went to the Morgan Guaranty Trust Co. in New York or the Credit du Nord in Paris. The Credit du Nord in Paris is the same bank that General Dynamics' check went into that started this investigation.

However, in 1985, primarily after the subcommittee's hearing in March, General Yoon withdrew the balance of his Dallas funds and deposited them into his family account with the Bank of America in San Francisco. These three destinations account for all the checks that we could identify in excess of $10,000, with the exception of one check to Yoo-Sung Kwak for $100,000. To date, we have been unable to determine who Ms. Kwak is or what she did to earn this money. Our listing of the Buyeon employees indicates Ms. Kwak was never associated with the company.

On August 22, 1985, the subcommittee issued a subpoena to the Bank of America. Upon examining the records of the Bank of America, we have learned that as of September, $75,000 remains in the bank, $70,000 has been sent to Korea, and about $180,000 has been written to cash. These cash transactions include checks of $53,000, $40,000, and $30,000. Figures 6 through 9 depict the deposits and withdrawals to the various Yoon accounts.

On August 22, 1985, the subcommittee issued a subpoena to the Morgan Guaranty Trust Co. An examination of the records of the Morgan Guaranty Trust Co. indicate that the moneys deposited in New York that were withdrawn, in excess of $20,000, were paid to individuals, the Paris bank, or sent to Korea. Ms. Kwak, from her Dallas bank, received an additional $110,000 out of this account, for a total of $210,000.

In addition, checks written in the amounts of $50,000, $20,000, and $20,000 were written to Messrs. K.D. Chang, Jamie Lee, and Mrs. Sai Song, respectively. Moreover, an additional $155,000 was sent to Paris. The final $170,000 did go to Korea. Similarly, with the bank in Dallas, the statements from the New York bank were sent to France.

As best we can tell, no one in Korea was aware that these various accounts existed or that such large sums of money existed. In fact, as will be discussed in more detail later, the assets of the company never reflected these balances.

With regard to the Credit du Nord, the Paris bank, we have had little success in gaining access to General Yoon's account records. We have been in contact with the Justice Department, and an effort is being made to secure access to these records. Although we have been unable to determine the exact nature of the transactions in Paris, we have substantiated that money went into Paris in addition to the moneys that were transferred from Dallas or New York. Dozens of checks from General Dynamics, General Electric, and United Technologies in excess of a million dollars were deposited directly into the Credit du Nord.

In total, we can account for more than $2.5 million in Yoon deposits to the Credit du Nord. To date, we have not determined where this money is nor whether or not it was used to make payments as Mr. Veliotis alleges.

Although our money trail ends with deposits in Paris, checks written to cash, or payments to unknown Koreans, it is clear that much of the money paid to General Yoon did not end up in Korea.

Figure 10 illustrates the financial status of the Buyeon Co. as represented by U.S. Embassy, Seoul, documents.

As can be seen from figure 10, not only do the assets of the company not reflect the company's various worldwide accounts, but the reported revenues, net worth, and profit figures do not reflect a company that was earning in excess of $1 million per year for its consulting services. Indeed, revenue figures on the Buyeon Co. gathered by U.S. Embassy, Seoul, underestimate by 50 percent the revenues actually generated.

For example, the Embassy reports consulting revenues in 1981 of less than $400,000, while U.S. company payments to Buyeon exceeded $800,000. This further confirms the pattern first identified in U.S. bank transactions and enables us to be sure that the money that flowed to Paris never reached the company in Korea.

Prior to uncovering General Yoon's money trail, we discussed his actions with officials from General Dynamics to determine if the Veliotis allegations were plausible. These officials contended that by comparing assumed office costs for Buyeon to revenues, there was not ample money available to make payoffs.

However, after examining the financial profile of the Buyeon Co., it is clear that either General Dynamics overestimated the office costs or that the Buyeon Co. did not have all of the assets—for example, manpower and equipment—that it claimed to have. For example, using General Dynamics' cost versus reported revenues, Buyeon would have incurred a net operating loss for 1978, 1980, and 1981, instead of making a profit. The costs projected by General Dynamics, therefore, are too high. Regardless of whether or not

General Dynamics' projections overestimate costs, their figures leave unaccounted revenues in excess of $2 million. Our analysis indicates unaccounted revenues are more in the neighborhood of $3.25 million.

In addition to these unique financial arrangements, these companies and the United States State Department had other curious relationships with General Yoon. For example, the U.S. Embassy in Korea recommended Buyeon as a "trade contact for interested U.S. firms." When we first advised the State Department that some of the U.S. companies involved with General Yoon had stated that the Embassy had recommended the firm, we were told that the Embassy does not make such recommendations.

However, when cables documenting the recommendations were discovered, State officials acknowledged the recommendations, but added that it was unusual. They could not elaborate. In addition, we requested that the U.S. Embassy in Seoul provide us with copies of their files relating to General Yoon or Buyeon. While their submissions were supposedly complete, the various company records contain a more comprehensive collection of cables than State's submission.

As identified in the subcommittee's March 25 hearing, General Dynamics billed General Yoon's consulting fees and expenses to the Government. According to United Technologies and General Electric officials, their payments were not billed to the Government. Martin-Marietta acknowledges some charges were billed, while LTV is still reviewing their accounts. Currently, the DCAA is attempting to determine whether any other companies had similarly billed the Government. To date, no such determination has been made.

Mr. Stockton and I contacted General Yoon and/or his lawyer on numerous occasions in an attempt to interview him regarding his activities. For approximately 2 months, he has effectively thwarted our attempts to interview him, claiming, among other things, he was either on vacation or could not speak English well enough to permit the interview.

During brief telephone interviews, Yoon stated that he needed the money in the Paris bank account to conduct business outside Korea. However, he did not elaborate on what this business entailed. He claimed not to have the records of that account that we could examine, and refused to grant us permission to examine the account. He claimed Ms. Kwak was a friend who was very much like a sister to him. He stated that she still lives in Seoul.

As seen, we have had little success in gaining useful explanations or cooperation from General Yoon regarding his activities. However, this hearing today should shed further light on the activities of General Yoon and Buyeon.

Thank you, and I will answer any of your questions regarding this investigation.

[Testimony resumes on p. 203.]

[Attachments to the prepared statement of Mr. Chafin follow:]

~Attachment #1

Company affiliated with	Relationship	Description of Products	Remarks
General Dynamics Corporation	Consultant since 1977	F-16 a/c AC&W Radar Stinger, Viper Phalanx Standard Missile	
Vought Corporation	Consultant since 1976	A-7 a/c MIRS	
United Technologies Sikorsky Aircraft Division	Consultant since 1978	UH-60A SH-60, S-76	
United Technologies Pratt & Whitney Aircraft	Consultant since 1978	F100 Engine	
United Technologies Norden System	Consultant since 1979	BCS SPS-10, SPS-67	
General Electric Company Marine & Industrial Projects Division	Consultant since 1978	LM2500 Gas Turbine for ROK Navy and for export ship	
General Electric Company Military Engine Projects Division	Consultant since 1979	Military a/c Engine Spare Parts	BOA
General Electric Company Electronic Systems Division	Consultant since 1980	Visual Simulation and Flight Training Equipment	Terminated as of Oct.30, 1981
General Electric Company Electronic Systems Division	Technical Service since Oct. 1, 1982 through Dec. 31, 1983	Electronic Enclosure Assemblies for ROK Navy	
Noske-Kaeser GmbH Hamburg, West Germany	Consultant since 1979	Air-Con system for naval ship	
Stromberg-Carlson Corporation	Sales Rep. since 1980	ESS/DCO Digital Branch Exchange	
Martin Marietta Aerospace, Orlando	Consultant since 1981	CLGP	
Aviquipo, Inc.	Consultant since Dec.1982	Central Power System for the airport	

ATTACHMENT 2

1035 1
R20003

RCA MAR 26 2245
UTC HFD

CC F. Peters

GENDYMIC J24762

ATT : MR. D. R. NELSON

WITH REFERENCE TO OUTSTANDING PAYMENT DUE UP TO DATE, I HEREBY REQUEST YOU TO BANK TRANYFER THE TOTAL AMOUNT TO THE NEWLY OPENED BUYEON COMPANY LIMITED BANK A/C NO. 01 2408 1 FIRST CITY BANK OF DALLAS ADDRESS. ONE MAIN PLACE DALLAS, TEXAS 75250 MEANWHILE, I DESIRE YOU WOULD TRANSFER ALL YOUR PAYMENTS TO BUYEON THROUGH ABOVEMENTIONED A/C IN THE FUTURE. I HOPE YOU WILL NEVER ADVISE OR COMMUNICATE US ON YOUR PAYMENT STATUS. I SHALL CHECK THEM FROM BANK STATEMENT.

Ed:
why?
I.N.

YOUR KIND ATTENTION WILL BE GREATLY APPRECIATED.

REGARDS, BUYEON CO., E.Y. YOON
T
UTC HFD

GENDYMIC J24762
REPLY TO THIS TELEX VIA RCA

RECEIVED
MAR 27 1981
FINANCIAL
SERVICES

FIGURE 1

PAYMENTS TO BUYEON BY U. S. COMPANIES

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	TOTAL
GENERAL ELECTRIC	--	--	--	--	73000	30000	123500	129000	318750	506250	562500	712500	282314	2737814
GENERAL DYNAMICS	--	--	--	27500	73472	117694	126148	433245	351994	658740	325982	290747	62500	2468022
UNITED TECHNOLOGIES	--	--	--	--	--	48717	93384	78343	108495	100195	104488	24863	110545	669030
LTV	4500	11709	26664	16500	35307	23861	135878	76897	56992	9055	31261	--	--	428624
MARTIN-MARIETTA	--	--	--	--	--	--	--	--	25000	55000	60000	60000	30000	230000
TOTALS	4500	11709	26664	44000	181779	220272	478910	717485	861231	1329240	1084231	1088110	485359	6533490

FIGURE 2

DEPOSITS TO BUYEON COMPANY, LTD., ACCOUNT
FIRST CITY BANK OF DALLAS, TEXAS
($10,000 or Greater)

SOURCE	MONTH/YEAR	AMOUNT
General Electric Co.	4/85	$ 81,250.00
	3/85	118,750.00
	10/84	230,000.00
	3/84	200,000.00
	12/83	41,666.66
	12/83	72,023.12
	10/83	41,666.67
	6/83	41,666.67
	5/83	10,042.11
	12/82	34,747.27
	3/82	225,000.00
	12/81	56,250.00
Subtotal		$1,153,062.50
United Technologies, Inc.	1/85	$ 55,000.00
	1/85	36,656.02
	10/84	285,899.46
	8/83	25,539.27
	1/82	36,666.60
	4/81	15,600.00
Subtotal		$ 455,361.35
General Dynamics Corp.	3/83	$ 31,543.33
	4/81	16,000.00
Subtotal		$ 47,543.33
(Unknown)	8/82	$ 31,259.80
TOTAL		$1,687,226.98

FIGURE 3

DEPOSITS TO EUNG YUL YOON ACCOUNT
FIRST CITY BANK OF DALLAS, TEXAS

($10,000 or Greater)

SOURCE	MONTH/YEAR	AMOUNT
General Electric Co.	5/81	$ 56,250.00
	7/80	32,250.00
Subtotal		$ 88,500.00
United Technologies, Inc.	8/80	$ 16,200.00
	7/80	15,446.49
Subtotal		$ 31,646.49
General Dynamics Corp.	7/81	$ 10,710.00
	7/81	13,068.42
	1/81	10,710.00
	12/80	10,710.00
	9/80	53,550.00
Subtotal		$ 98,748.42
LTV	11/81	$ 25,328.98
	7/81	27,163.50
	12/80	13,684.79
	8/80	13,909.51
	5/80	13,603.86
Subtotal		$ 93,690.64
(Unknown)	7/81	$ 22,496.69
TOTAL		$335,082.24

FIGURE 4

WITHDRAWALS FROM BUYEON COMPANY, LTD., ACCOUNT
FIRST CITY BANK OF DALLAS, TEXAS
($10,000 or Greater)

PAYEE	MONTH/YEAR	AMOUNT
Kwang Ho/K.H. Yoon	3/85	$ 22,000.00
(General Yoon's son)	1/85	40,000.00
	1/85	10,000.00
Subtotal		$ 72,000.00
Mrs. N.J. Yoon	4/85	$ 192,000.00
(Kwang Ho Yoon's wife)		
Credit du Nord	2/85	$ 55,000.00
(All transactions were	11/84	527,000.00
transfers to the E.Y. Yoon	5/84	200,000.00
account in Paris)	2/84	12,000.00
	12/83	181,000.00
	11/83	50,000.00
	5/83	14,433.23
	3/83	40,160.94
	1/83	20,000.00
	12/82	28,055.00
	2/82	19,000.00
	10/81	76,620.00
	5/81	35,000.00
Subtotal		$1,258,269.17
Morgan Guaranty Trust Co.	4/84	$ 10,005.00
(All transactions were	12/83	20,000.00
transfers to the E.Y. Yoon	7/83	47,705.51
account in New York City)	6/82	14,000.00
	3/82	20,000.00
	3/82	12,000.00
	3/82	201,500.00
	6/81	20,000.00
Subtotal		$ 345,210.51
Yoo-Sung Kwak	1/82	$ 100,000.00
Cash	3/83	$ 34,000.00
(Unknown)	8/82	$ 44,000.00
TOTAL		$2,045,479.68

FIGURE 5

WITHDRAWALS FROM EUNG YUL-YOON ACCOUNT
FIRST CITY BANK OF DALLAS, TEXAS
($10,000 or Greater)

PAYEE	MONTH/YEAR	AMOUNT
Morgan Guaranty Trust Co.	1/84	$ 11,000.00
	1/82	10,000.00
	7/81	20,000.00
	1/81	23,000.00
	7/80	16,000.00
Subtotal		$ 80,000.00
Credit du Nord	7/81	$ 28,000.00
	1/81	28,000.00
	10/80	51,886.39
Subtotal		$107,886.39
Unknown	5/81	$ 56,000.00
	8/80	16,200.00
	8/80	43,800.00
	1/80	10,000.00
Subtotal		$126,000.00
TOTAL		$313,886.39

FIGURE 6

DEPOSITS TO KWANG-HO YOON ACCOUNT
BANK OF AMERICA, RICHMOND DISTRICT BRANCH, SAN FRANCISCO
($10,000 or Greater)

SOURCE	MONTH/YEAR	AMOUNT
Buyeon Co. Account, Dallas	3/85	$ 22,000.00
	1/85	40,000.00
	1/85	10,000.00
Subtotal		$ 72,000.00
Kim Na-Jung Yoon Account, San Francisco	5/85	$ 70,000.00
	5/85	85,000.00
	5/85	10,000.00
Subtotal		$165,000.00
(Unknown)	1/85	$ 10,000.00
	11/84	17,000.00
Subtotal		$ 27,000.00
TOTAL		$264,000.00

FIGURE 7

DEPOSITS TO KIM NA-JUNG YOON ACCOUNT BANK OF AMERICA, RICHMOND DISTRICT BRANCH, SAN FRANCISCO

($10,000 or Greater)

SOURCE	MONTH/YEAR	AMOUNT
Buyeon Co. Account, Dallas	4/85	$192,000.00
Kwang-Ho Yoon Account	6/85	$ 70,000.00
	1/85	40,000.00
Subtotal		$110,000.00
TOTAL		$302,000.00

FIGURE 8

WITHDRAWALS FROM KWANG-HO YOON ACCOUNT
BANK OF AMERICA, RICHMOND DISTRICT BRANCH, SAN FRANCISCO
($10,000 or Greater, Plus Cash Withdrawals)

PAYEE	MONTH/YEAR	AMOUNT
Cash	8/85	$ 1,000.00
	7/85	2,000.00
	7/85	1,000.00
	7/85	1,533.00
	7/85	1,500.00
	7/85	1,200.00
	5/85	8,000.00
	5/85	1,000.00
	5/85	1,500.00
	4/85	1,500.00
	4/85	1,000.00
	4/85	1,500.00
	3/85	2,000.00
	3/85	2,000.00
	3/85	5,000.00
	3/85	1,000.00
	2/85	1,000.00
	2/85	2,500.00
	1/85	40,000.00
	1/85	1,500.00
	1/85	5,000.00
	11/84	1,000.00
	10/84	1,000.00
	8/84	4,000.00
	8/84	4,500.00
	7/84	1,900.00
Subtotal		$ 95,133.00
Kim Na-Jung Yoon Account	6/85	$ 70,000.00
	1/85	40,000.00
Subtotal		$110,000.00
Bank of America	5/85	$ 70,017.50
Champion Buick	9/84	$ 10,054.96
(Unknown)	1/85	$ 10,000.00
TOTAL		$295,205.46

FIGURE 9

WITHDRAWALS FROM KIM NA-JUNG YOON ACCOUNT BANK OF AMERICA, RICHMOND DISTRICT BRANCH, SAN FRANCISCO

($10,000 or Greater)

PAYEE	MONTH/YEAR	AMOUNT
Mr. K.H. Yoon	5/85	$ 70,000.00
	5/85	10,000.00
	4/85	85,000.00
Subtotal		$165,000.00
Mrs. Kim Na-Jung Yoon	6/85	$ 70,000.00
Mr. L.H. Shier	1/85	$ 10,000.00
Cash	8/85	$ 53,000.00
	4/85	30,000.00
Subtotal		$ 83,000.00
TOTAL		$328,000.00

FIGURE 10

BUYEON COMPANY, LTD.
FINANCIAL STATUS ($000)

	1976	1977	1978	1979	1980	1981	1982	1983	1984
CURRENT ASSETS	11	--	55	--	63	136	--	--	182
FIXED ASSETS	24	--	79	--	52	42	--	--	77
CURRENT LIABILITIES	45	--	91	--	69	173	--	--	154
LONG-TERM DEBT	NONE	--	NONE	--	8	NONE	--	--	15
NET WORTH	11	--	43	--	45	219	--	--	96
PROFIT	(31)	--	19	--	13	12	--	--	28
ACTUAL REVENUES	44	182	220	479	717	861	1329	1084	1088
REPORTED REVENUES (U.S. EMBASSY SEOUL)	--	--	159	--	328	387	--	502	581

Mr. **Dingell**. The committee thanks you for a very helpful and, I believe, a very complete statement which has been of considerable value to the committee.

The Chair will now recognize my colleagues in the order of their seniority before the gavel fell, and then members in the order of their appearance after the gavel fell.

The Chair recognizes first the gentleman from Oregon Mr. Wyden.

Mr. **Wyden**. Thank you very much, Mr. Chairman.

Mr. Chafin, we thank you for an excellent job. We would like to start by having you describe the five companies' histories with regard to payments by General Yoon or the Buyeon Co.

Mr. **Chafin**. I am sorry, I didn't hear you.

Mr. **Wyden**. We would like to start by having you describe the five companies' history with regard to payments to General Yoon or the Buyeon Co.

Mr. **Chafin**. The five companies vary in the way they have dealt with General Yoon. As we discussed in the statement, Martin-Marietta sent their fees directly to Seoul. They were negotiated in Seoul. Their expense money was sent directly to Dallas per General Yoon's request. On two occasions, they accidently mailed expense money to Seoul, and it was taken to Paris for deposit.

As they point out, expense money is a reimbursement of expenses that you've outlaid, and there is no tax problems or anything like that associated, so they were not concerned—had no reason to be concerned, in their opinion—of these deposits in the United States and Paris.

The other companies, though, all deposited direct fees into Dallas. General Electric deposited approximately $1.35 million into the two accounts of the First City Bank. They sent other moneys to Korea that ultimately showed up into the Paris bank account.

General Dynamics wired-transferred their moneys to Seoul, and then in the middle of this, changed and began sending checks. Those checks all came back to Paris or back to Dallas for negotiation. They subsequently went back to wire transfer.

United Technologies, per General Yoon's request—and I believe it was attachment 2 of the statement—was asked to put the money directly into Dallas, and they were further asked not to notify people in Korea of these deposits. In total, I believe, they put $450,000 into the Dallas bank and then subsequently some of their checks showed up in Paris that were sent to Seoul.

We believe all of the money of the LTV Corp. went to Dallas. All of the records that we have indicate the money went to Dallas. Unfortunately, the Dallas bank records only go back to 1980, but as far as I can see, none of their money did go to Paris, but at the same time, I don't see any money being sent to Seoul. It all went into the Dallas bank.

Mr. **Wyden**. Considering the requirements of the Foreign Corrupt Practices Act, should the companies have been concerned when General Yoon requested that his fee be deposited outside Korea?

Mr. **Chafin**. In the staff's opinion, and in the opinion of many of the companies involved, this should have raised a red flag: "Why does General Yoon want his money put into Dallas; what possible explanation could there be?"

More importantly, when they see their money sent to Seoul, come back out, and go to Paris, that should have raised a red flag.

While in and of themselves, the deposits are not illegal, they can very easily be the potential first step in getting the necessary funds available to make the payments.

Mr. WYDEN. What about this further request not to notify individuals in Korea?

Mr. CHAFIN. Now you've got a double red flag coming up. Not only does he want his money outside of the country, he does not want anybody to know about it. That should have raised a lot of concerns with the companies, in our opinion.

Mr. WYDEN. Now, my understanding is, United Technologies officials raised some questions about this.

Mr. CHAFIN. Yes. We have an internal memo from United Technologies—it is attachment 2—that there are initials. But we can guess at who we are talking about. Ed Peterson is being asked by a Mr. Nelson, "Why do they want this? What's going on here?"

We don't know what the answer is. I am sure United Technologies will be able to help us with that when they testify.

But the bottom line is we see the concerns being raised, we see the red flags coming up, and yet if you notice the date on this, this was 1981, they complied with the request for 4 years.

Mr. WYDEN. You mentioned that LTV was involved with General Yoon while he was president of Korea Tacoma Marine Industries. Could you tell us a little bit more about this company?

Mr. CHAFIN. As best we can understand, Korea Tacoma Marine Industries is a private company operating in Korea. Some General Dynamics documents on it indicate they had had some dealings with the company and with Yoon when he was there in connection with the F-16 sales. However, their relationship did not begin until he started Buyeon.

Their documents show that this company, Korea Tacoma Marine Industries, supposedly has great influence with the Korean defense establishment. In fact, the company supposedly sold the French Exocet program directly to President Park and, in addition to General Yoon, had a Mr. Kim, who was the brother of the prime minister, as its chairman. We had heard that there may have been problems with the company in the 1970's. We have been unable to find out if any types of scandals or problems had arisen. But we have heard that.

Mr. WYDEN. In total, how much of the $6.5 million appears to be missing, in your view?

Mr. CHAFIN. The way we calculate it, I would say it is about $3.25 million. We can account for it in excess of $2.5 million going to Paris; we can find almost $200,000 in cash missing, in the Bank of America; we have got exactly $300,000 in checks above $20,000 going to these Koreans—again we don't know who they are—and then another quarter of a million dollars that was sent to an unknown destination from New York—for a total of $3.25 million.

Mr. WYDEN. Well, your answer indicates that the bulk of the money has gone to Paris. What have we done to get access to that account?

Mr. **Chafin**. Early on in the investigation, we were in contact with the Justice Department. We have been keeping them apprised of our findings on the investigation, the fact that the other companies are involved, the fact that these accounts existed, and once we subpoenaed the records and saw more about this Paris bank account, we explored various avenues that this subcommittee may be able to gain access to the Paris bank.

When we found out we did not seem to have a clear path to go there, we turned to the Justice Department. If I understand the procedure correctly, they have to file a brief with the U.S. courts, get a court order to examine the accounts, present the accounts to the Government of Paris, and if they honor the court order, we will get into the account.

The other way we explored was when we talked to General Yoon, he said he wants to cooperate and clear this up, and we told him that a significant way to clear this up would be to allow us access to the Paris bank account.

We volunteered to put an investigator on a plane, fly him out to San Francisco, and confiscate those records. But General Yoon said he did not have copies of the Paris bank accounts there. And we said. "Well, we will put an investigator on a plane, fly him out, and you can sign a statement that we can present to the Credit du Nord in Paris that would give us access to the account." He declined to do so.

Mr. **Dingell**. The time of the gentleman has expired.

The Chair recognizes now the gentleman from Texas, Mr. Bryant.

Mr. **Bryant**. Thank you, Mr. Chairman.

Mr. Chafin, do we have any indications beyond your statement as to the identity of Ms. Bahk, the individual living in France, who is receiving the various bank statements. We have been told that General Yoon has a daughter living in France. We have not been able to ascertain what her name is. We would assume that she could be his daughter—living with a married name.

Mr. **Chafin**. As far as Mrs. Kwak goes, in talking with the General the other day, we asked him who this Kwak person was, and he first said he didn't know who we were talking about, and then I gave him the full name, and he said, as I mentioned in the statement, "She's like my sister."

When we learned that she was still living in Seoul, we were concerned. We've got $210,000 sent to Mrs. Kwak, could that money be moving on into somebody's pocket? We cannot find a Mrs. Kwak in any type of official position. And then it occurred to us, "Well, maybe her husband has a different name," and we tried to go that route.

So we asked General Yoon what the husband's name was. He seemed to get rather upset and was fumbling for about 10 seconds, and then he says, "Well, I think she's divorced now." And we said, "Well, that's OK. Who was her husband? You know, it would still be germane."

And he started fumbling again, and he came back, and he said, "Well, I think he's dead." And we said, "OK. Well, we're sorry to hear that he's dead. But when he was alive, what was his name?"

And he said, "Well, I think it was Lee something or other," and ended the conversation with that.

So we seemed to have hit a raw nerve with this Mrs. Kwak, but you know, without General Yoon's help, we have been unable to do much. The FBI has been informed of these names and has tried to figure out exactly who they are, but no luck.

Mr. **Bryant**. In your discussions with General Dynamics, didn't they claim that Veliotis' accusations with regard to the Buyeon Co. and Mr. Yoon didn't hold up because Yoon didn't assist them on winning the F-16 contract?

Mr. **Chafin**. Yes, that is what they told both Mr. Stockton and myself. In addition, Congressman Wyden was there for the briefing and the discussion. They claimed that it did not make sense that, A, Yoon was not involved in the F-16 and, more importantly, that the decision had been made prior to Yoon ever working with them to go with the F-16. They claimed that the F-16 decision was locked up in 1974-75, but, in fact, the contract wasn't signed until 1981.

Mr. **Bryant**. And what were the names of the individuals at General Dynamics who told you that?

Mr. **Chafin**. Joe Serrano, Marlene Carver, and their counsel.

Mr. **Bryant**. Now, did your subsequent investigation indicate something totally different?

Mr. **Chafin**. On Monday afternoon or night, General Dynamics gave us a huge box of documents, at least a thousand, I would say. And as a matter of fact, Mr. Stockton and I were still reviewing them last night for the first time.

There is quite a few references in there on what General Yoon did not contribute to the F-16 sale, and I think it is just summed up best by George Durr, the head of the General Dynamics Tokyo office, who said that, "We may have won the program with someone else's assistance. But there was no one else. We could not have won the program without his assistance," and the "his" we're referring to is General Yoon.

Mr. **Bryant**. Beyond the Veliotis accusation and the curious flow of money, do we have any other evidence of illegal payments?

Mr. **Chafin**. Once again, this box of information that came in Monday has got a number of documents in there that we think deserve, you know, further exploration. I would assume that will probably occur today. Unfortunately, like I mentioned, we were up late last night still going through them for the first time and have not had a chance to discuss them with General Dynamics and find out exactly what this means.

But to give you an example, we have a letter or a memo being sent to Mr. Veliotis from Ron Craig, in which the following comment is made, and again this is a quote, "General Yoon states that our compensation over the past few years doesn't begin to cover his expenses and that he has invested significant personal assets to ensure his country obtain the F-16."

In addition, there are other documents, as I mentioned, that refer to various obligations that we should be able to explore with the General Dynamics witnesses.

Mr. Bryant. Let me ask you if you could tell us briefly what contracts these other companies have in Korea that might have been affected by Mr. Yoon?

Mr. Chafin. Attachment 1 shows you the various things that Buyeon was working on for the various companies. Without going through it all, with General Dynamics it was the F-16, the Stinger; with GE there was generators; United Technologies, the F-100 engine.

Mr. Bryant. And what was his success rate, or what was their success rate?

Mr. Chafin. It varies with the companies. We probably should ask this of them. I have not posed the exact question. But I would say, based on my discussions with the companies, he has been probably most successful for GE and GD. He was less successful for LTV and Martin-Marietta.

Mr. Bryant. And United Technologies?

Mr. Chafin. Put them in the middle.

Mr. Bryant. OK. One last question and then I will let someone else ask a question.

At the State Department, who was it that made the recommendation to use Mr. Yoon? Who signed that memorandum?

Mr. Chafin. It was not from the State Department. It came in the cables from Seoul. I can go back at least to 1976 and show you this recommendation. The individuals in the State Department are rotating through, but the recommendation stays the same. It was various people within the State Department that effectively were sending the cable from the Embassy back to either State or Department of Commerce with this recommendation in it.

It's been a continuing recommendation that probably has gone on 10 years.

Mr. Bryant. I would like to follow up, but I am out of time.

Mr. Dingell. The time of the gentleman has expired.

The Chair recognizes the gentleman from Virginia, Mr. Bliley.

Mr. Bliley. No questions.

Mr. Dingell. The Chair recognizes the gentleman from Kansas, Mr. Slattery.

Mr. Slattery. Mr. Chafin, I am wondering why it is that we are unable to determine why the State Department is recommending that General Yoon be used, or why it is we can't identify within the State Department how they got in the position of recommending General Yoon?

Mr. Chafin. Mainly because the recommendation is coming from the Embassy in Seoul and we are dealing with the State Department here, and these officials are not cognizant of what the thinking is there and why these recommendations are being made.

Mr. Slattery. Who have you dealt with here in Washington in the State Department?

Mr. Chafin. The various desk people and, I guess, the lawyer.

Mr. Slattery. Are they now aware that we have a potential problem with General Yoon?

Mr. Chafin. Yes.

Mr. Slattery. Have they ceased recommending that people use him?

Mr. Chafin. The last cable that came out that depicts the company's financial status, et cetera, that also generally contains a recommendation, was prior to our March 25 hearing. The next scheduled cable would not be out until next year. I would be very surprised to see if the recommendation is still there.

I will follow up with one other thing. At one point in this investigation, I got a little concerned that maybe we had stumbled into something we shouldn't be into with regard to something the State Department might be doing. And so I said, "Look, between you and me, is there any reason we should get out of this and leave this thing alone?" And they said, "Oh, no. This is a solid company. There's no problems here. There is no covert type things. This is not a front organization. It's a real trading company."

Mr. Slattery. What kind of cooperation have you had with the State Department here? I mean, I don't understand why, when you call the State Department, if you're talking to the right people over there, why they can't pick up the phone and call the Embassy in Seoul and say, "You know, what's the deal? Who's recommending this guy?" Why can't we get that information?

Mr. Chafin. Our relationship with the State Department has been that anything we want, we must submit in writing, the chairman has signed quite a few documents to request information from the State Department. They generally will send a telex or cable out, and we are looking usually at 1 month to 6 weeks turnaround times. It is not like you or I would think, that they'd pick up the phone and place a call. They have not done it for us.

Mr. Slattery. So you don't know who in the Seoul Embassy is recommending or has recommended——

Mr. Chafin. Like I say, if we go to the cables, we will find different names at the bottom, depending on the years we are looking at.

Mr. Dingell. If the gentleman will yield?

Mr. Slattery. I would be happy to yield.

Mr. Dingell. We are looking forward to the presence of the State Department to discuss these matters with the committee, and I think on conclusion thereof we will have a higher level of cooperation from the State Department.

Mr. Slattery. Very good. I don't have any further questions at this time. I yield back any time that I might have.

Mr. Dingell. The Chair thanks the gentleman.

The Chair recognizes the gentleman from Kansas, Mr. Whittaker.

Mr. Whittaker. I have no questions, Mr. Chairman.

Mr. Dingell. The Chair recognizes the gentleman from Minnesota, Mr. Sikorski.

Mr. Sikorski. Thank you, Mr. Chairman.

Mr. Chafin, again I want to commend you for a fine job under difficult circumstances, following this money all around. As I understand this—and the gentleman from Oregon pressed Mr. Lewis at the March hearing here on this issue—springboarding from a Business Week article that quoted Veliotis as claiming that moneys from General Dynamics were, for all intents and purposes, under the auspices and direct knowledge of the higher-ups in the corporation, going for bribes into Egypt and into Korea.

It's my understanding that, subsequent to that article, staff met with Mr. Veliotis and that he made, as your statement indicates today, a statement once again that this money that was paid under this general topic called "consultant services" was used by Yoon for bribing officials in Korea. Is that what you found out?

Mr. CHAFIN. That is what he told us. And I guess, if you look—we could not get to the final answer—but if you look at the parameters of what General Yoon was telling us.

Mr. SIKORSKI. He told you that he—Veliotis, that is—had some contact with General Yoon, is that correct?

Mr. CHAFIN. Yes.

Mr. SIKORSKI. At General Dynamics he was, what, executive vice president?

Mr. CHAFIN. Right.

Mr. SIKORSKI. And he also was in charge of international sales for a short period of time. Is that correct?

Mr. CHAFIN. I believe so.

Mr. SIKORSKI. And it's also my understanding that the documents that you received from General Dynamics establish quite clearly that Mr. Veliotis was a participant in the contractual negotiations and the contractual relationship between General Dynamics and Mr. Yoon. Is that correct?

Mr. CHAFIN. Yes. Based on the documents we have seen, there is no doubt that Mr. Veliotis was in a position to know.

Mr. SIKORSKI. He was involved in those discussions with Mr. Yoon——

Mr. CHAFIN. He was involved in the discussions.

Mr. SIKORSKI [continuing]. And within General Dynamics?

Mr. CHAFIN. He was receiving memos briefing him on exactly what the status was and what Mr. Yoon was stating and those types of things.

Mr. SIKORSKI. Now, Mr. Veliotis has made statements to you that he has documentation as to the veracity of his claim that these moneys went to Mr. Yoon for bribery purposes?

Mr. CHAFIN. He claims he has documentation of Yoon asking for $5 or $6 million. In fact, in the documents we received Monday, we see a document that related to a phone call Mr. Yoon placed to—and I've lost the name right now—but a General Dynamics official. In that, he is calling and worried, in effect—it has come out that he's had this conversation with Veliotis—he's asked for $5 or $6 million, and they want to know if he really said that. He says he doesn't remember, but he's concerned that Veliotis has made a tape of it.

Mr. SIKORSKI. Now, as to the parameters of Mr. Veliotis' claims and the veracity thereof, he said that the payments to Yoon were to end up in Korea to secure business with General Dynamics. Is that correct?

Mr. CHAFIN. The payments were not going to end up in Korea. They were going to end up someplace else so that nobody could investigate.

Mr. SIKORSKI. But the money would end up in the pockets of Korean officials who were in a position to influence contracts?

Mr. CHAFIN. Right. That's what the allegation is.

Mr. SIKORSKI. And these consultant services arrangements are what shields that process and that begins the process of the money flowing in that direction.

Mr. CHAFIN. Exactly. We will hear from the companies in a little while, but if the contention is that—I pay the money, I paid it to a consultant, and at that point I have no obligation, and I don't know what he did with it; and if he took it all over the country or if he took it out of the country to third countries, we have no responsibility, we have no cognizance—it has effectively made the Foreign Corrupt Practices Act in this regard toothless.

Mr. SIKORSKI. That's right. We've got money going outside—the money from General Dynamics and the others, but money from General Dynamics in this instance—going from General Dynamics to Mr. Yoon, with a request that it not come to him into Korea.

Mr. CHAFIN. Right.

Mr. SIKORSKI. At least in a method that would flag it to someone in Korea.

Mr. CHAFIN. Correct.

Mr. SIKORSKI. Then he further requests that no information flow to Korea with regard to that financial arrangement.

Mr. CHAFIN. Right. And if the companies can comply with this and not break any laws, then Mr. Veliotis is right on the mark in terms of when you put a middle man in there, you can skirt the act.

Mr. SIKORSKI. And as I understand, in the General Dynamics instance, originally there were wire transfers to Korea, then in 1980 there were several cash payments, is that correct?

Mr. CHAFIN. According to the documents we received Monday night.

Mr. SIKORSKI. And then Mr. Yoon requested direct deposits in Dallas, which should have raised some questions.

Mr. CHAFIN. Correct.

Mr. SIKORSKI. And then General Dynamics changed the payment mode and sent the checks to Korea, but these checks in a form, physical form, that were then deposited in Paris and Dallas bank accounts.

Mr. CHAFIN. General Yoon requested General Dynamics make deposits in Dallas just like United Technologies was doing, just like LTV was doing and just like GE was doing. General Dynamics never made those direct deposits for General Yoon, but they did switch to the check mode, which enabled General Yoon to physically get the money out of Korea without ever leaving a trail in Korea that the money had, in fact, been paid.

Mr. SIKORSKI. And the total from General Dynamics was $2.5 million that you could find?

Mr. CHAFIN. Their total payments were $2.5 million.

Mr. SIKORSKI. Right.

Mr. CHAFIN. The money——

Mr. SIKORSKI. The bank accounts were 150——

Mr. CHAFIN. Yes, the money that went to Paris was approximately $600,000, and the money that came back to Dallas was approximately $150,000.

Mr. SIKORSKI. And in conclusion, you have over $3.25 million in unaccounted revenues from the five defense contractors that we're talking about, to Mr. Yoon, close to $3 million in the Paris bank account. Is that correct?

Mr. CHAFIN. That is what we found.

Mr. SIKORSKI. And you've got a location where payments could be made undetected by the Korean or the U.S. Government authorities, and five major contractors appear to have cooperated in this process. Is that correct?

Mr. CHAFIN. In varying degrees; yes.

Mr. SIKORSKI. Well, what I see, Mr. Chairman, is nothing inconsistent with the scheme that Mr. Veliotis talked about that he knew of and has documentation of. In fact, everything we've seen is entirely consistent with this kind of scheme. It appears that all five contractors terminated their contracts with General Yoon shortly after this subcommittee's March hearing.

Is that your understanding, Mr. Chafin?

Mr. CHAFIN. LTV had terminated its relationship with General Yoon prior to the March 25 hearing. Four of the five terminated after the hearing.

Mr. SIKORSKI. All five of them are now terminated.

Mr. CHAFIN. I misunderstood you. I thought you said all five.

Mr. SIKORSKI. No.

Mr. CHAFIN. All five are terminated. Four of the five terminated after. LTV terminated prior.

Mr. SIKORSKI. Well, it appears that Mr. Yoon became a liability and not such a great asset at this point.

I thank the chairman and the staff for an excellent investigation.

Mr. DINGELL. The Chair thanks the gentleman.

Mr. Chafin, the committee thanks you for your assistance in this matter.

Were there further questions for Mr. Chafin at this time?

[No response.]

Mr. DINGELL. The Chair hears none.

Mr. Chafin, you are excused, with the thanks of the subcommittee for a very fine job well done, and with the commendations of the subcommittee for your efforts here.

The Chair announces that our second panel was to be Retired General Eung-Yul Yoon, president of Buyeon Co., Ltd. The Chair looks forward to the cooperation of General Yoon, and the committee will discuss the matters that will be done to achieve a greater level of cooperation here.

The Chair announces that our next panel then will be a panel composed of: Mr. Richard B. Smith, manager of business and market development operation, Aircraft Engine Group, General Electric; Mr. Joseph W. Serrano, staff vice president, General Dynamics Corp.; Mr. Peter K. Chapman, president, United Technologies International Business Corp.; and Mr. Howard Fish, vice president, international, for LTV Aerospace; and Mr. Dan A. Peterson, vice president, business development, Martin-Marietta Corp.

Gentlemen, we thank you for your presence here today. If you would each come forward and take your place at the witness table, we will proceed with preparations for your testimony.

Gentlemen, as you come forward, the Chair will inform you each that you all have the right to be accompanied by counsel if it is your desire, for purposes of advising you with regard to your rights and with regard to the limitations on the committee's powers.

Do any of you desire to be accompanied by counsel?

Mr. SMITH. No.

Mr. SERRANO. No.

Mr. CHAPMAN. No.

Mr. Fish. No.

Mr. PETERSON. No.

Mr. DINGELL. The record will then so indicate that none of you have that desire.

The Chair will inquire, do any of you object to testifying under oath?

Mr. SMITH. No.

Mr. SERRANO. No.

Mr. CHAPMAN. No.

Mr. FISH. No.

Mr. PETERSON. No.

Mr. DINGELL. The Chair will advise each of you gentlemen that copies of the rules of the committee, rules of the House, and rules of the subcommittee are there before you, the blue and green books, for your information both as to your rights and as limitations upon the powers of the committee.

Gentlemen, if you do not object to being sworn then, as you have indicated, if you will please each rise and raise your right hand.

[Witnesses sworn.]

Mr. DINGELL. Gentlemen, you may each consider yourself under oath.

Gentlemen, the Chair thanks each of you for your presence and your assistance to the committee today. The Chair observes that you each have short statements, so we will commence, on your right and on my left, with Mr. Peterson first, and then proceed across through Mr. Smith, Mr. Fish, Mr. Chapman, and Mr. Serrano. If you would, please, gentlemen, as you begin your statement, would you identify yourself for the assistance of our reporter?

TESTIMONY OF DAN A. PETERSON, VICE PRESIDENT, BUSINESS DEVELOPMENT, MARTIN-MARIETTA CORP.; RICHARD B. SMITH, MANAGER, BUSINESS AND MARKET DEVELOPMENT OPERATION, AIRCRAFT ENGINE GROUP, GENERAL ELECTRIC, CO.; HOWARD M. FISH, VICE PRESIDENT, INTERNATIONAL, LTV AEROSPACE AND DEFENSE CO.; PETER K. CHAPMAN, PRESIDENT, UNITED TECHNOLOGIES INTERNATIONAL BUSINESS CORP.; AND JOSEPH W. SERRANO, STAFF VICE PRESIDENT, GENERAL DYNAMICS CORP.; ACCOMPANIED BY MARLENE CARVER

Mr. PETERSON. My name is Dan A. Peterson. I am vice president, business development, for Martin-Marietta Corp., headquartered in Bethesda, MD. In my current position I am responsible for business development of the corporation, including international operations.

At the time Buyeon Co., Ltd., headed by General Yoon, was engaged as a consultant, I was in charge of the International Group of Martin-Marietta's Orlando Aerospace Division, with overall supervision for international business development efforts.

I would like to give you some basic information regarding the policies and procedures which govern our retaining of foreign consultants, and then give you some detailed information with respect to our contractual relationships with Buyeon.

It is Martin-Marietta's policy that the furnishing of services by a foreign consultant and the payment therefor be in compliance not only with U.S. law but foreign laws and regulations as well.

Shortly after passage of the Foreign Corrupt Practices Act, Martin-Marietta reviewed, analyzed, and revised its accounting policies and procedures to ensure compliance with the act. Since then, Martin-Marietta Internal Audit audits for compliance on a continuing basis.

The authority to contract for such services is restricted to the principal officer of each operating element or division. The requestor of the services is required to justify the use of the consultant and to establish the credentials of the requested consultant. The corporate legal department is required to conduct an extensive background investigation on the consultant, including personal interviews.

The consultant is required to furnish, prior to contract execution, a certification that, A, no payments or gifts have or will be made to improperly influence foreign officials in connection with the corporation's foreign business; B, no foreign official has any legal or beneficial interest in such business or in any commission or payment the corporation may make; and C, the consultant has complied with all applicable laws, including any applicable registration and licensing requirements.

Further, the consultant is required to furnish annually a certificate that he has not made any illegal payments to foreign Government officials.

Martin-Marietta conducted an extensive background investigation into Buyeon Co., Ltd., and General Yoon specifically. Our investigation included contacts with, one, several major U.S. companies who had previously or were then doing business with Buyeon; two, the U.S. Department of Commerce; and three, the American Embassy in Seoul; in addition to references supplied by General Yoon.

In a telegram to the Department of Commerce from the American Embassy, Seoul, it was stated that the Embassy, "recommends BCL (Buyeon Co., Ltd.) as a trade contact for interested U.S. companies." The Embassy further stated that Buyeon Co., Ltd. was a registered offer agent with existing agreements with several large U.S. defense contractors.

In addition, the Minister of the Korean Embassy, Washington, DC, characterized General Yoon in early 1981 as an excellent choice. A separate investigation was also conducted by Martin-Marietta's own security personnel, and General Yoon was personally interviewed by several staff members of Martin-Marietta Corp., including the corporation's international counsel.

The results of our investigation were positive and failed to disclose any reason why we should not utilize Buyeon or General Yoon as a consultant. Quite to the contrary, respondents considered Buyeon and General Yoon to be well respected, straightforward, and with solid credentials.

In a personal interview, General Yoon stated specifically that he fully understood the Foreign Corrupt Practices Act, that tight controls are maintained in Korea, and no commissions are allowed by the Korean Government in military procurement, and that he maintains close control over his employees and approves every penny that is spent.

Under the agreements between Martin-Marietta and Buyeon between 1981 and June 1985, Buyeon was generally engaged as an independent contractor to provide marketing research and analysis and assistance in sales efforts for products and services of Martin-Marietta in the Republic of Korea.

Further, Buyeon was to provide legally available information on Korea's defense organization. As a part of the consulting agreements, Buyeon was to advise Martin-Marietta with respect to business practices, commercial expectations, and social customs in Korea. It was to advise Martin-Marietta of any changes in local business or legal conditions which could affect the corporation's marketing strategy.

In addition, Buyeon was tasked to assist Martin-Marietta in obtaining entry visas for corporate personnel who may travel or stay in Korea. It was also required to assist the corporation in obtaining transportation, medical care, and suitable banking and similar services for corporate personnel who travel or stay in Korea.

Other terms and conditions of the agreement relate to competitor analysis, responding to customer questions, reporting on product performance, and assisting in such ways as may be reasonably required.

As compensation under the initial agreement, Martin-Marietta paid Buyeon an annual retainer fee of $50,000 plus reimbursement of expenses of $14,993.37. The term of this agreement was July 1, 1981, through June 30, 1982.

Martin-Marietta entered into subsequent agreements with Buyeon, all for 1-year terms, from July 1, 1982, through June 30, 1985. Buyeon's annual retainer fee was increased to $60,000 per year plus reimbursement of expenses. As of July of this year, we no longer have any relations with Buyeon or with General Yoon.

Buyeon and General Yoon were paid retainer fees and expenses only, and were not entitled to commission payments in the event of sales.

During the 4 years that Buyeon was a consultant for Martin-Marietta Corp., Buyeon was paid a total of $230,000 in retainer fees and reimbursed $73,990.33 for expenses. Buyeon requested that payment for retainer fees be made in Korea and that payment for reimbursement of expenses be made to Dallas, TX. Consequently, all retainer fee checks were sent to Buyeon's offices in Seoul, Korea, and checks for reimbursement of expenses were sent to a Buyeon company bank account in Dallas, TX.

Two expense checks, however, were mistakenly sent to Buyeon's Seoul office. A review of our canceled checks show that all the checks sent to Dallas were negotiated in Dallas. All checks sent to Korea were negotiated in Korea with the exception of the two expense checks which were mistakenly sent to Korea. These two checks were negotiated at a Paris bank.

Payments were made to Buyeon only after receipt of invoices from Buyeon, which were then reviewed by Martin-Marietta project directors, contract managers, and accounting staff prior to processing for payment.

In addition, as part of our contract renewal with Buyeon each year, Buyeon was required to sign the statement that it had complied with the policies of the International Traffic in Arms Regulations and the Foreign Corrupt Practices Act with respect to political contributions, fees, and commissions and the payment of money or gifts to foreign officials.

We believe that the entire course of our relationship with Buyeon Co., Ltd. was mutually satisfactory. Buyeon was engaged to provide the corporation with specific consulting services as they related to the corporation's interests in the Republic of Korea. Our initial investigation and subsequent detailed background investigation of Buyeon and General Yoon indicated and convinced us that they were highly qualified to provide these services. The fees and expenses paid were reasonable when compared with the services rendered.

The corporation wishes to cooperate fully with this committee's investigation and is prepared to respond to any questions which you may have.

That concludes my prepared remarks.

Mr. **Dingell**. Thank you very much, Mr. Peterson.

The Chair recognizes now Mr. Smith.

TESTIMONY OF RICHARD B. SMITH

Mr. **Smith**. Thank you, Mr. Chairman.

My name is Richard Smith, and I am manager of the business and market development operation for the Aircraft Engine Group of the General Electric Co. In that capacity I am responsible for worldwide field sales activities for the Aircraft Engine Group and, therefore, responsible as well for the field sales employees of General Electric Co. and also all independent nonemployee sales representatives supporting our efforts in the aircraft engine business.

It is my understanding the committee's interest is in our previous business association with the Buyeon Co. in the Republic of Korea, and my comments are directed toward that relationship.

The Aircraft Engine Group first retained the Buyeon Co. in 1977 for the purpose of assisting us in obtaining orders for gas turbines utilized for propulsion on ships to be built for the Korean Navy. Previously, that Navy had used either steam or diesel propulsion, and we saw this as a good opportunity to market the superior product that had been very successful in other parts of the world, including substantial use by the U.S. Navy. Not only were we facing competition from the supplier of steam turbines and diesel propulsion systems, but also Rolls-Royce was actively competing with an aircraft engine derivative.

The Buyeon Co., whose president was ex-air force General Yoon, was a company knowledgeable in the marine business. We received favorable comments on the credentials of that company from a number of Government sources with whom we checked, including the U.S. Embassy, and entered into a consulting agreement on marine propulsion equipment.

We have renewed that agreement annually with the Buyeon Co. over the several years and added an additional agreement in 1979 for them to represent us in selling and processing orders for spare parts for the Korean Air Force with respect to General Electric engines, which are used on a large number of F-4 and F-5 aircraft operated by the Korean Air Force.

Under these agreements, the Buyeon Co. was responsible for technical and commercial interfaces with our ship propulsion customers and the Korean Air Force with the objective of helping us develop these into promising business opportunities.

Buyeon was asked to, and did provide on a continuing basis, information on these customers' needs and the competitive activities of Rolls-Royce. They identified and assessed any problems the customers were having, made suggestions on how we could enhance the reputation of our products with the customer, assisted us in obtaining prompt and accurate payments for the engines and parts we had delivered, and provided ongoing advice on customer decision criteria. They provided introduction and support for the many General Electric people who frequently visited the customers' facilities, including four separate shipyards utilizing our products.

They performed these functions very well and kept us all well informed on our progress with these customers, as the documents which we have submitted to the committee at its request demonstrate. Also, you have received our assessment reports of the services that were provided for us by the Buyeon Co.

Both the naval and ship propulsion program and the engine spare-parts program have been very successful during this period. Over the past 8 years, we have sold $109 million of gas turbines and related parts to the Korean Navy and approximately $27 million of engine spare parts to the Korean Air Force. The Buyeon Co. had received over the same period as our representative approximately $2.7 million in fees, or approximately two percent of the total sales.

As the person responsible for field sales, I regard this as a very successful and cost-effective approach. On a simple cost basis, I am confident hat it would have cost us much more over this period to have had an American sales engineer physically residing in Korea. Such a person would still have required substantial help in identifying and obtaining access to the people in the customer organizations who need information and had to be convinced that they should buy our products.

We would, moreover, have suffered from the usual problems of being a foreigner trying to do business with Korean purchasers. The Buyeon Co. has been able to supply substantially more sales, technical, and clerical personnel to pursue the sales and customer relations opportunities and then make sure that the obligations we undertook were fulfilled not only to our satisfaction but to that of the customer. Speaking as a sales manager, I think that this has been a very good approach to this particular market.

However, in the spring of this year, there were indications from our customers in Korea that the effectiveness of Buyeon as a result of consequences—as a consequence of matters having nothing whatever to do with the General Electric Co. would be substantially reduced in the future. Because of that, we suspended operation of the agreement with the Buyeon Co. on May 10 of this year, and on June 5, 1985, we terminated our contracts.

I understand among the questions raised with respect to the Buyeon Co. is the question as to whether they have engaged in any improper payments. So far as my company is concerned, the answer is categorically "No." Our contract specifically provided that in its activities in our behalf Buyeon would not directly or indirectly pay, offer, or authorize anything of value to any person or organization contrary to applicable law, including those laws in the United States such as the Foreign Corrupt Practices Act and the laws of Korea.

A copy of our company policy with respect to these issues was appended to the signed contracts. Many people in the Aircraft Engine Group have personal contacts with this organization as well as our customers involved in the representation activity. At no time has there been any indication whatsoever of improper conduct.

We also were advised last week that the committee is interested in finding out whether any of the money we paid for this sales consultant was reimbursed by the U.S. Government. Amounts paid to the Buyeon Co. were not specifically charged to any U.S. Government account. I am told that the Stevens amendment of 1985 clearly established that foreign selling costs were not reimbursable.

Prior to that time, Buyeon charges were not explicitly excluded from Aircraft Engine Group's overhead used in our forward-pricing calculations. To this extent, some portion of Buyeon charges may have been included in our prices.

Finally, I understand some questions have been raised as to the manner in which the Buyeon Co. was paid its compensation. In our case, our payments were made by U.S. bank checks or wire transfers to the Buyeon Co. itself. We have maintained all supporting records, and these have been submitted to the committee. These payments were processed by the company's international accounting operation in accordance with the terms of the contract which they had on file. All such payments were made either to banks in Korea or in the United States or picked up at our offices by representatives of the Buyeon Co.

I can only say from our standpoint there was nothing improper about these payments or in the manner in which they were made.

In summary, our payments to the Buyeon Co. were in reasonable amounts relative to the services provided and the results achieved.

Thank you.

Mr. DINGELL. Thank you, Mr. Smith.

Mr. Fish.

TESTIMONY OF HOWARD M. FISH

Mr. FISH. Thank you, Mr. Chairman. My name is Howard M. Fish. I am vice president, international, of the LTV Aerospace and Defense Co., a subsidiary of the LTV Corp., appearing here today at your request to assist you in your inquiry into certain activities of Mr. E.Y. Yoon, a retired general of the Korean Air Force and his affiliate, Buyeon, Ltd., as his activities may relate to the subcommittee's legislative oversight of the Federal securities laws and their administration by the Securities and Exchange Commission.

I understand that you desire information from LTV Aerospace and Defense concerning an overview of the type of contractual relationship LTV Aerospace and Defense had with Mr. Yoon. As you are aware, we have furnished the subcommittee with copies of all the records pertaining to the consulting agreements LTD—or LTV Aerospace and Defense had with Mr. Yoon and Buyeon, Ltd., which describe in detail the entire business relationship between LTV and LTV Aerospace and Defense and Mr. Yoon.

However, in order to further assist you in this inquiry, I have taken the liberty of having this business arrangement summarized. I will now read it into the record.

The first agreement between LTV and Mr. Yoon lasted from October 9, 1973, through August 20, 1974, pursuant to which Mr. Yoon was LTV's representative in Korea during a period of further exploration of business opportunities for LTV subsidiaries in Korea. Under the terms of this agreement, Mr. Yoon was paid a fixed fee of $1,500 per month. This first agreement was superseded by an agreement between Mr. Yoon and the LTV Aerospace and Defense Corp., a predecessor of LTV Aerospace and Defense Co. This was executed on August 20, 1974.

Pursuant to this agreement, Mr. Yoon was to be a consultant on matters in the Republic of Korea, covering necessary administrative, public relations, and marketing functions for the period July 1, 1974, through June 30, 1975. The consulting fee pursuant to this agreement was $2,500 per month plus enumerated expenses. This agreement was amended three times, which collectively reduced the monthly fee to $1,500 and extended the agreement 15 months through September 30, 1976. This agreement expired by its own terms on September 30, 1976.

The final agreement between Mr. Yoon and the then-Vought Corp., which is now LTV Aerospace and Defense Co., was executed on May 1, 1977. Pursuant to this agreement, Mr. Yoon was engaged as Vought's consultant in Korea concerning the sale of A-7 aircraft, Lance missiles and related products to the Republic of Korea. Initial compensation rate for Mr. Yoon pursuant to this agreement was $3,000 per month plus enumerated expenses. This agreement was amended a total of seven times which variously extended the agreement through December 31, 1983, incrementally increasing the monthly rate to a high of $6,000 during 1979 and then eventually decreasing the payments to Mr. Yoon to only preapproved incurred expenses during the 1982-83 time period.

In addition, in 1981 the agreement was amended so that the scope of Mr. Yoon's consulting services was to promote sales of A-7 and multiple-launch rocket system to the Government of Korea. The agreement expired on December 31, 1983.

In addition to these agreements with Mr. Yoon, on July 1, 1978, Vought entered into a month-to-month rental agreement with Buyeon Co., Ltd. That agreement required Buyeon to furnish office space, telephone and telex services, office equipment, secretarial help, utilities and fuel, an automobile and other office items for Vought use. Vought agreed to pay his rent, the actual costs of the office space, and other equipment and services. This agreement was terminated on December 31, 1979.

We have not sold any products or services to the Republic of Korea as a result of Mr. Yoon's consultancy.

Sir, this finishes my prepared statement. Of course, I am available to answer any questions that the committee might have.

Mr. **Dingell**. Thank you very much.

Mr. Chapman.

TESTIMONY OF PETER K. CHAPMAN

Mr. **Chapman**. Thank you, Mr. Chairman.

My name is Peter Chapman, and I should like to say good morning to you, sir, and those members of the subcommittee that I did not meet earlier this morning.

We have given a statement to the subcommittee which I would appreciate being made part of the transcript. In the interest of time I will briefly summarize that statement.

I am president of United Technologies International Business Corp. This subsidiary was formed in February 1985 to support the global business and marketing activities of United Technologies Corp. and its operating divisions and subsidiaries.

I assumed my current responsibilities when that subsidiary was formed. In addition, I have been involved in sales for various units of United for over 9 years. I am generally conversant with the relationship between the Buyeon Co. and the four separate United units which it represented in Korea. Those units are Pratt & Whitney Government Products Division, Norden Systems, Sikorsky Aircraft, and Hamilton Standard.

Buyeon Co.'s representation of these units extended from 1978 through 1985. All these relationships have now ended. The last of these relationships was terminated in April 1985. My prepared statement includes a table reflecting all of United's payments to the Buyeon Co. from these operating units. All payments to the Buyeon Co. except the one commission sale for a commercial sale by Sikorsky Aircraft were consulting fees and reimbursement of expenses.

The consulting fees were established annually in advance. All payments under consulting agreements from all four units combined from the 7 years from 1978 through 1985 totalled $669,000–$669,030. The $237,532 commission on the sale of the commercial S-76 Sikorsky helicopter was lower than Sikorsky's standard commission rate.

The fees paid to the Buyeon Co. by United were reasonable in light of our business activity in Korea during the last 7 to 8 years. All payments were made through a single United Technologies subsidiary by checks or bank wire transfers to Buyeon Co., Ltd.

No payments made to the Buyeon Co. under any agreement was included in overhead or was in any other way charged to the U.S. Government.

Before retaining foreign representatives, all of our operating units must comply with stringent internal procedures set up to ensure compliance with U.S. laws. The Buyeon Co. was subjected to this full review and approval process. Each of the agreements with the Buyeon Co. contain representations and warranties that no payments would be made directly or indirectly to any official or employee of any government or any agency or instrument of any government. We have no knowledge that any improper payments were made by the Buyeon Co. or General Yoon.

Nevertheless, in view of the various allegations about improper payments and our concern for the high standards of reputation and integrity that United demands of its representatives, United Technologies terminated all relationships with the Buyeon Co.

United Technologies is firmly committed to ensuring that all of its operating units comply with the letter and spirit of the U.S. law. Toward that end, it retains the Washington, DC, law firm of Covington Burling to advise it on matters pertaining to the Foreign Corrupt Practices Act.

United has fully advised Covington and Burling of all aspects of United's relationship with Buyeon Co. and General Yoon. Covington and Burling has advised us that they see nothing in that relationship which violates any U.S. law or regulation.

In summary, United Technologies believes that its dealings with the Buyeon Co. fully comply with U.S. law. We conducted extensive and positive background checks. Our internal Foreign Corrupt Practices Act compliance procedures are designed to assure compliance with U.S. law. They were followed to the letter. All fees were modest in amount compared to the business involved.

We promptly severed our relationship upon learning of the allegations against Buyeon Co. Our transactions with the Buyeon Co. have been reviewed and approved by outside counsel. We have behaved lawfully and responsibly, and I am now prepared to answer your questions.

Thank you, sir.

[The prepared statement of Mr. Chapman follows:]

Statement of Peter K. Chapman
President
United Technologies International Business Corporation
before the
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
United States house of Representatives
October 2, 1985

Mr. Chairman and Members of the Subcommittee:

Thank you for giving me the opportunity to make this opening statement.

My name is Peter Chapman.

I am President of United Technologies International Business Corporation. This subsidiary was formed in February of 1985 to support the global business and marketing activities of United Technologies Corporation and its operating divisions and subsidiaries.

I assumed my current responsibilities when that subsidiary was formed. In addition, I have been involved in sales for various units of United for over nine years. I am generally conversant with the relationship between the Buyeon Company and the four separate United units which it represented in Korea. Those units are Pratt & Whitney - Government Products Division, Norden Systems, Sikorsky Aircraft and Hamilton Standard.

Buyeon Company's representation of these units extended from February 1, 1978, through May 22, 1985. All these relationships have now ended. The last of these relationships was terminated in April 1985.

Attached to this statement is a table reflecting all of United's payments to the Buyeon Company from these operating units. All payments to the Buyeon Company, except the one commission sale for a commercial sale by Sikorsky Aircraft, were for consulting fees and reimbursement of expenses. The consulting fees were established annually in advance. All payments under consulting agreements from all four units combined from 1978 through 1985 totalled $669,030. The $237,532 commission on the sale of the commercial S-76 Sikorsky helicopter was lower than Sikorsky's standard commission rate. The other units retained the Buyeon Company as a commission sales representative for commercial sales -- but no such sales were made and no commissions paid.

In our opinion, the fees paid to the Buyeon Company by United were reasonable in light of the business activity in Korea during the last seven to eight years. All payments were made through a single United Technologies subsidiary by checks or bank wire transfers to Buyeon Company, Ltd.

No payment made to the Buyeon Company under any agreement was included in overhead or was in any other way charged to the U.S. Government.

Before retaining foreign representatives, all of our operating units must comply with stringent internal procedures set up to ensure compliance with U.S. laws. The Buyeon Company was subjected to this review and approval process. The Company conducted a detailed background investigation which included receipt of a positive report from a representative of the U.S. Department of Commerce at the American Embassy in Seoul, a Dun & Bradstreet Report, and personal meetings with General Yoon to inquire into his business affiliations and confirm his company's integrity, reputation and abilities. Updated reports were obtained when each contract with the Buyeon Company was renewed.

Each of the agreements with the Buyeon Company contained representations and warranties that no payments would be made directly or indirectly to any official or employee of any government or of any agency or instrumentality of any government.

In March, 1985, a Wall Street Journal article reported allegations that the Buyeon Company was linked to questionable payments to Korean officials. In addition, we learned of this Subcommittee's hearings which involved the Buyeon Company and our counsel learned that General Yoon was the subject of inquiries in Korea.

In fact, we have no knowledge that any improper payments were made by the Buyeon Company or General Yoon. Nevertheless, in view of these allegations and the high standards of reputation and integrity that United demands of its representatives, United Technologies terminated all relationships with the Buyeon Company.

Pratt & Whitney gave 30 days' notice of termination to the Buyeon Company on April 22, 1985, and the termination was effective on May 22, 1985. The Sikorsky agreements, which expired on January 31, 1985, were not renewed. The Norden agreement with the Buyeon Company had already expired by its terms on January 31, 1984, and was not renewed.

United Technologies is firmly committed to ensuring that all of its operating units comply with the letter and spirit of U.S. law. Toward that end, it retains the Washington, D.C. law firm of Covington & Burling to advise it on matters pertaining to the Foreign Corrupt Practices Act. That firm, in fact, assisted United in setting up the internal procedures with which all units must comply before using any foreign representatives. United has fully advised Covington & Burling of all aspects of United's relationship with Buyeon Company and General Yoon. Covington & Burling has advised us that they see nothing in that relationship which violates any U.S. law or regulation.

In summary, United Technologies believes that its dealings with the Buyeon Company fully comply with U.S. law. We conducted extensive and positive background checks. Our internal Foreign Corrupt Practices Act compliance procedures are designed to assure compliance with U.S. law. They were followed to the letter. All fees were modest in amount compared to the business involved. We promptly severed our relationship upon learning of the allegations against Buyeon Company. Our transactions with the Buyeon Company have been reviewed and approved by outside counsel. We have behaved lawfully and responsibly. I am now prepared to answer your questions.

FEE TABLE

Consulting:

	1978	1979	1980	1981	1982	1983	1984	1985
Pratt & Whitney Aircraft Government Products Division	$48,717*	$53,784*	$30,954	$40,784	$50,936	$53,304	$ 9,556	$65,000
Sikorsky Aircraft			$27,589	$31,045	$45,926	$51,184	$15,307	$45,545
Norden Systems, Inc.	0	$39,600	$19,800	$36,666	$ 3,333	0	0	0
Hamilton Standard	0	0	0	0	0	0	0	0
Commission:								
Sikorsky Aircraft							$237,532	

* payments made under joint consulting agreement covering services to Sikorsky and Pratt & Whitney.

Attachment

Mr. DINGELL. We thank you.
Mr. Serrano.

TESTIMONY OF JOSEPH W. SERRANO

Mr. SERRANO. Thank you and good morning, Mr. Chairman, and members of the committee, ladies and gentlemen.

My name is Joseph W. Serrano. I am staff vice president and director of International Offset Operations of General Dynamics, a position I have held since February of this year. I joined the company in 1977, and my tenure with General Dynamics has covered the years in which much of General Dynamics' international business has been developed.

Prior to the mid-1970's General Dynamics was not a major factor in international business. Its presence has grown, however, in the last decade. Following the development of the F-16 aircraft, the company's international marketing effort expanded. Within the last 10 years General Dynamics has been awarded contracts for foreign sales totaling $5.8 billion and it has competed for an additional $6 billion of contracts.

I am appearing at this hearing to give testimony at the committee's request, concerning the company's relationship with its former consultant, Buyeon Co., Ltd., headed by Yoon Eung-Yul.

Just as General Dynamics made Mrs. Marlene Carver, director of international administration, available to the committee on July 9 and 10, so also Mrs. Carver is available today to answer any questions on administrative matters that the committee might have. We are prepared to cooperate fully with the committee.

The company terminated its relationship with Buyeon in April 1985. And for some months prior thereto, there was a growing dispute with Buyeon over the role it was to play as a consultant for General Dynamics. General Yoon was interested in a larger role. He wanted to be an agent, a role that was not required by General Dynamics which had, a year earlier, established its own office in Korea.

After the company, in June 1984, delineated what it expected of Buyeon, the problem got worse. Early this year it deteriorated to the point where, on March 19, Yoon met with the company in St. Louis in an effort to resolve the problem. At that time, Yoon himself was not making his services available as required by the contract. When this situation continued into April, Buyeon was terminated. At the same time, the company learned that Yoon was depositing checks General Dynamics issued in Korea to Buyeon in banks outside of Korea, a potential violation of the consulting agreement.

General Dynamics first identified General Yoon as a possible consultant about 1974-75, when the company was contemplating a marketing effort in South Korea. He was then chief executive officer of Korea Tacoma Marine Industries, KTMI, a Korean company. Neither Mr. Yoon nor KTMI was then performing any services for General Dynamics.

General Dynamics checked Mr. Yoon's and KTMI's credentials through the American Embassy in Seoul, the office of the Senior

Secretary for Economic Affairs of Korea, and the Baker & McKenzie law firm office in Tokyo.

Yoon was initially engaged in an individual capacity in February 1976. Shortly thereafter, Buyeon Co., Ltd. was organized with Yoon as president and a director, and the company assumed the role of consultant for General Dynamics in Korea. Yoon was engaged because General Dynamics believed he was competent to perform essential technical advisory services.

From 1976 to 1983 Buyeon provided office facilities and administrative support for General Dynamics' visitors and employees in their substantial efforts in South Korea. After those 7 years, the company opened its own in-country office, and from 1976 to 1985, Buyeon advised General Dynamics in its marketing of Stromberg-Carlson commercial telecommunications products, Standard Missile, radar systems, and the F-16.

The Buyeon organization provided field-trial logistic support for commercial rural telephony digital switch and military radar retrofit programs and assisted company personnel in establishing Government and industrial contacts—all under the cognizance and supervision of the South Korean Government. It performed translation and interpreter services, and it advised on Government trends and social, cultural, and business practices.

General Yoon's Buyeon Co. consisted of five professional employees in 1976. By 1984, Yoon had built an organization that included 12 professional and 9 support employees. Buyeon's estimated office costs from 1977 through 1984 totalled $3.4 million, an average of $425,000 a year, of which 33 percent, or $141,666, per year was allocable to General Dynamics. The remainder was assigned to other clients.

Buyeon invoiced General Dynamics for a total of $1.2 million for office and administrative support which, documented and invoiced by Buyeon, included $502,000 allocated for corporate administrative support costs, $441,000 allocated to Fort Worth and other divisions, and $269,000 to Stromberg-Carlson.

In addition to the $1.2 million in documented administrative support and other expenses, consultant retainer fees were paid to Buyeon totaling $1.3 million during the 10-year, 1976-through-1985 period. The first-year, 1976, consulting fee was $27,500. Thereafter, the consulting fee rose until a 5-year contract was signed by Yoon in 1982 for an annual retainer of $250,000. This retainer amount eliminated any further payment by General Dynamics for administrative support costs beginning March 1983.

When Buyeon was engaged as a consultant, General Dynamics was sensitive to and made every effort to ensure legality in engaging Buyeon and in defining the role it and its principal officer, Yoon, were to play. Although the Foreign Corrupt Practices Act was not in existence at the time, the investigations that led to its passage were well under way.

General Dynamics' conduct with respect to the retention of Buyeon would have been in compliance with the letter and the intent of that law, and it remained so throughout the term of the relationship. In July 1979, when the consulting arrangement with Buyeon was renewed, the agreement included language specifically requiring adherence to the Foreign Corrupt Practices Act. A similar provision was also a part of the renewed contract executed in 1982, retroactive to 1981. This agreement continued in effect until Buyeon's termination this year.

The company has absolutely no indication or reason to believe that Buyeon or its president, Yoon, ever, in any way, violated this provision of its contracts. A question asked Mrs. Carver and myself on July 9 and 10 was, why didn't we ask the Korean Government? It wasn't necessary.

Mr. Chairman, and gentlemen of the committee, it wasn't necessary because, in fact, the Government of Korea asked General Dynamics for records earlier this year, after the newspaper articles about General Yoon.

And I would like this statement entered. At the 125th Plenary Congressional Meeting in Korea, the Republic of Korea answered as follows, and I quote:

> Let me answer on the background of the F-16 purchase. Requirement for aircraft came up in 1970, along with the plan for modernization of the Air Force, and in 1974, Korea and the United States exchanged a bilateral Memorandum of Understanding concerning the prospective sale of F-16 to Korea. * * * The sale has not been promoted by the manufacturer or trading agent * * *. I can clearly say that the rumor about payoff is totally groundless.

At a hearing by this committee last spring, it was pointed out that a check representing a payment by General Dynamics to Buyeon was deposited in a bank in Paris, France. The questions of the committee caused an audit to be made of all checks issued by General Dynamics to Buyeon. Copies of those found have been furnished this committee.

I have no explanation for the deposits of some checks in banks outside of South Korea. I can tell you that all payments made by General Dynamics to Buyeon were, consistent with our policy, by wire transfer or check to Buyeon in Seoul, South Korea.

That is my statement on Buyeon Co. and its principal, General Yoon. During a meeting with this committee staff on July 9 and 10, I stated essentially the same facts, but in greater supporting detail. If there are any questions, I will try my best to respond.

Mr. **Bryant**. Mr. Chairman.

Mr. **Dingell**. The gentleman from Texas.

Mr. **Bryant**. Before we leave Mr. Serrano's statement, he departed from his written text and made reference to something that took place before the Korean Congress, and I wondered if he—since it's not printed—if he could go over that again and tell us what he was talking about before we go to regular questions.

Mr. **Dingell**. Mr. Serrano, could you go over the matters relative to the comments you made on the matters in the Congress of the Republic of Korea.

Mr. **Serrano**. Yes, sir. Shortly after the publicity in the press in the United States—statements of Veliotis—the Korean Minister of Defense and Chief of Staff of the Air Force visited the Fort Worth Division. During their visit, they expressed concern about the allegations about Yoon that appeared in Mr. Veliotis' remarks and requested that we provide whatever information we could to assist the Government in investigating what was an allegation harmful to the reputation of a United States ally and of our customer.

And we said, "Certainly, we will cooperate." And essentially, we provided them the very same materials that we provided your committee, Mr. Chairman, earlier this year.

And they indeed conducted their own investigation, and of course, in their Congress, May 23-24, the Korean Congressmen had a number of questions of the Ministry of Defense. The Minister of Defense on May 31 in the newspapers in Korea reported the proceedings of those hearings in Korea.

And his statements that I was quoting from were from the proceedings of Friday, May 24, in response to Congressman Song Won-Yong: "It certainly is a sad matter for our Nation to have gotten involved with an international scandal—the allegations on accepting bribes in connection with the purchase of the F-16 fighter aircraft." And the Prime Minister and the Defense Minister were asked to respond to those questions. They did so; and they said, no impropriety.

Mr. **Sikorski**. Mr. Chairman.

Mr. **Dingell**. The gentleman from Minnesota.

Mr. **Sikorski**. I know we will return to this, but the question obviously has to be raised as to why the gentleman from General Dynamics cites some kind of Republic of Korea congressional forum and not the internal General Dynamics memoranda as to the role of Mr. Yoon with regards to the F-16: one from Mr. Durr, who as I understand was in charge of the Tokyo office for the area international sales, and one from Mr. Ron Craig to Veliotis in December, both of which extol Mr. Yoon's indispensable involvement in that F-16 contract.

Mr. **Wyden**. I would like to follow up the very good point of the gentleman from Minnesota. You are really calling Mr. Durr a liar, and you are calling Mr. Chafin incorrect.

Here is what Mr. Durr said: "We may have won the program with someone else's"——

Mr. **Dingell**. If the Chair may proceed, the Chair is going to recognize the members for questions. I think the proper way to do this would be to proceed through the recognition of the members in appropriate order.

Under the rules and practices of the committee, the Chair recognizes for 5 minutes the gentleman from Oregon, Mr. Wyden.

Mr. **Wyden**. Well, thank you, Mr. Chairman.

I want to follow up on the very important point made by the gentleman from Minnesota because it seems to me, Mr. Serrano, you are calling Mr. Durr a liar and Mr. Chafin incorrect.

What Mr. Durr, the head of General Dynamics' Tokyo office, stated of Yoon, "We may have won the program with someone else's assistance, but there was no one else. We could not have won the program without his assistance."

Now, aren't you saying that Mr. Durr is lying?

Mr. **Serrano**. I am saying that is a misrepresentation of the F-16 situation in Korea. It is a matter of public record that there was a committee in Korea known as the 706 Committee to select a fighter aircraft.

Mr. **Wyden**. But the record is replete on this point. A memo from Ron Craig to Mr. Veliotis says, "I am convinced that Buyeon's efforts were one of the major factors in the successful F-16 sale. He has been supporting the F-16 since 1974, the first 2 years with no compensation."

Mr. **Serrano**. I think that the records that you are referring to are the same records that we provided the SEC. My recollection is—it is one of a number of memos of similar nature raising the recommendation that Yoon be paid more, and adding to Yoon's own requesst to be paid more. Yoon is a very tough negotiator.

But you will also find records that——

Mr. **Wyden**. Excuse me. We have Mr. Durr saying this. We have Mr. Craig saying this. We have Mr. Veliotis saying this. And we would like to hear from you some personal knowledge or documentation that would support your point of view.

Mr. **Serrano**. Yes. And I think that you will find in those same documents provided you, the fact that on March 11, or 12, 1975, accompanied by a U.S. Air Force officer, the Chief of Staff of the Air Force visited Mr. Lewis in St. Louis, where they indicated that Korea was satisfied with the selection of the F-16; that, in 1977, as I recall, that Secretary Brown, at the security consultative meeting, indicated that he agreed in principle for the United States for the acceptance of the Korean request for 50 F-16 aircraft; that, in 1978, there was a confirmation for a lower number of F-16's government to government. These documents were also in the materials provided you—they were contemporaneous documents of what happened in 1975.

I believe that the letter you're looking at is a 1982 letter or representation.

Mr. **Wyden**. When did General Dynamics get a signed agreement with the Government of Korea?

Mr. **Serrano**. We did not get a signed agreement with Korea. The LOA, which was the signed agreement between the Government of Korea and the United States Government, was about 1981. And we, in turn, are then contracted for the delivery of the 36 aircraft.

But it was a government-to-government sale.

Mr. **Dingell**. Would the gentleman yield?

Mr. **Wyden**. I would be happy to yield.

Mr. **Dingell**. Mr. George Durr, is who, if you please, sir?

Mr. **Serrano**. George Durr is the Region Director, Far East.

Mr. **Dingell**. Far East. Now, I don't have the date on the information in the letter, but I will ask the staff to make a copy available to you. It says as follows, "We may have won the program with somebody else's assistance. But there was no one else. We could not have won the program without his assistance." That's referring to Mr. Yoon. It says, "Yoon is an extremely forceful and persistent man and as a result has developed some bad feelings by some of the divisions who seem to want to question his usefulness rather than to recognize the value of his advice."

Now, that's in the letter. And I will give you a copy of it so that we can deal fairly on this matter.

Mr. **Wyden**. Mr. Chairman, excuse me. Just very briefly, that last sentence after the point where you stopped, it goes on to say, "The recently signed LOA is proof of the pudding." And I interrupt the chairman only because I thought it——

Mr. **Dingell**. I am proceeding on the gentleman's time.

Now, in another one—it's to Marlene Carver, St. Louis, and it says, "Re Yoon agreement," and the letter is signed by George. Really, it's signed "George." I guess this is George Durr again.

But the second letter is to Marlene Carver, and it's dated September 1, 1982. It says, "We wish you'd feel part of the GD family, for there is little doubt that you are the best and the most productive consultant working for General Dynamics."

Now, that refers to "Re Yoon agreement." The paragraph above says, "Although it's taken a long time to resolve the problems associated with your consulting contract, we believe the new contract addresses all the concerns that you have related to myself and others here in St. Louis."

I guess that is a quote from a communication to Mr. Yoon by Mr. Durr. Am I correct in that assumption?

Mr. SERRANO. Yes, Mr. Chairman. This is a confirmation of September 1982; a confirmation that we did get around to resolving our disputes over the type of contract that General Yoon should have. And this is from Mr. Durr.

I would have to say that as to the representations both of Mr. Durr and Mr. Craig, the proof of the pudding is the company's position on what Yoon was to be paid. It was less than any of them had recommended. The facts are—and I know Mr. Fish maybe cognizant of that selection by Korea of the F-16—and my opinion is: that the statements of Mr. Craig and Mr. Durr are overstatements and are not accurate.

Mr. DINGELL. Of course, it is fair to observe that Mr. Yoon remained on the payroll until March or April of this year. Is that correct?

Mr. SERRANO. That's correct.

Mr. DINGELL. The Chair apologizes for consuming so much of the gentleman's time. The Chair will compensate him for the time that the Chair would have used.

The gentleman from Oregon continues to be recognized.

Mr. WYDEN. Well, again, your own memo to Ms. Carver from you and W. Gorvine recognizes the role of Mr. Yoon, June 10, 1982,

> General Yoon led us to believe that he incurred expenses over the past eight years which were substantially in excess of the amount which he had received as compensation from General Dynamics in support of General Dynamics' now successful F-16 effort. Without having records with him, he estimated that GD compensation amounted to only about 30 percent of expenses incurred in behalf of General Dynamics.

That's your own memo.

Mr. SERRANO. Yes. Bill Gorvine and I said that he represented they were legal, and we said, "If you have documentation, fine."

Mr. WYDEN. Well, you're now coming and telling us it didn't mean anything.

Mr. SERRANO. Well, I am saying that, sure, the guy could make claims. He always did. But we weren't about to make any payments or changes in his contract if we saw no justification.

Mr. WYDEN. But it's clear he's working on the F-16.

Mr. SERRANO. Yes, he did work on the F-16. Yes, he did assist us in logistical and technical and administrative support, assisting us in going through the maze of Air Force protocol requirements. He did that.

Mr. **Wyden**. But it certainly contradicts what you told me and Mr. Stockton and Mr. Chafin in the summary.

Mr. **Serrano**. I don't believe that it does.

Mr. **Wyden**. I was there, and it clearly does.

Mr. **Serrano**. I am sorry, sir, I don't believe that it does—if you could recall what I did say then.

Mr. **Wyden**. You cited there was no involvement in the F-16.

Mr. **Serrano**. I cited that he was not the cause of the agreement for the government-to-government sale of the F-16, but I did clearly say, as I best recall, that Yoon provided technical advisory, administrative an logistics services.

Mr. **Wyden**. And you certainly urged that he be given hundreds of thousands of dollars.

Mr. **Serrano**. We urged that——

Mr. **Wyden**. For his good work on the F-16.

Mr. **Serrano**. He represented all the products of General Dynamics, sir.

Mr. **Wyden**. In your 1982 contract negotiations, General Yoon attempted to remove all requirements forcing Buyeon to observe U.S. laws, including compliance with the Foreign Corrupt Practices Act. Why was that?

Mr. **Serrano**. I don't know on what basis. We have always insisted that Yoon and that we would comply with the FCPA. In fact, that was an issue at the very beginning of our relationship with General Yoon and in 1978.

But, you know, I don't recall that that ever occurred—that Yoon asked for exemption of General Dynamics' or any of the requirements of U.S. law.

Mr. **Wyden**. Let us get the attachment.

[Pause.]

Mr. **Dingell**. The Chair advises that the time of the gentleman from Oregon has expired, and the Chair will recognize now the gentleman from Minnesota, Mr. Sikorski.

Mr. **Sikorski**. Thank you, Mr. Chairman.

Mr. Serrano, General Dynamics made payments to Buyeon outside of Korea, is that correct?

Mr. **Serrano**. Sir?

Mr. **Sikorski**. Did you make any payments to the Buyeon Co. outside of Korea?

Mr. **Serrano**. In the early years, as I understand it—and Mrs. Carver might be better able to clarify this—there may have been about $50,000 that General Yoon received in cash in Tokyo. But other than that, all of our payments were by DHL of any checks to Seoul or wire transfer.

Mr. **Sikorski**. Did Buyeon officials ever pick up payments from General Dynamics offices in the United States?

Mr. **Serrano**. Not to my knowledge.

Mr. **Sikorski**. Were checks mailed from General Dynamics to Korea deposited in Korea?

Mr. **Serrano**. Because the fact that the committee brought it to our attention, we then checked and found that there were checks that General Yoon negotiated outside of Korea that we had, in fact, DHL'd to him.

Mr. **Sikorski**. In fact, we know now that at least around $600,000 was deposited in Paris and $150,000 in Dallas. Isn't that correct?

Mr. **Serrano**. That's correct.

Mr. **Sikorski**. Did General Yoon obtain approval from the president of the Bank of Korea to establish a branch office in the United States?

Mr. **Serrano**. We have no knowledge of that, sir.

Mr. **Sikorski**. The reason I ask that is there is an internal legal opinion given to General Dynamics with regards to the propriety of that, and under that legal opinion Mr. Yoon, if he were not to violate the laws of Korea, would have to get approval from the Bank of Korea for just such a branch. Isn't that correct?

Mr. **Serrano**. I believe that's correct, yes, sir.

Mr. **Sikorski**. Was General Dynamics aware of these deposits? I think you testified you were not, until the subcommittee brought them to your attention.

Mr. **Serrano**. That is correct. We were not.

Mr. **Sikorski**. If not, why not?

Mr. **Serrano**. Just as with any of our suppliers, we had no reason. We were receiving, in our judgment, good value for the services that we contracted. General Yoon and his organization did a good job for us. We had no reason to suspect what he, as any other supplier, was doing with the money that we paid to him that was justified by contract. In that incident of the one check, the specific request that Yoon made that the November 1982 fee payment be made by check, DHL, was reversed by the Yoon organization seven months later, around May 1983. And so, going back to wire transfer, we had no reason to suspect that anything wrong was going on.

Mr. **Sikorski**. Well, if you had been aware, you would have gone back to wire transfers, is that correct?

Mr. **Serrano**. It was okay for us to have made an arrangement to pay him in the United States, because we had that checked out with Baker & McKenzie in 1978. But our understanding is, if the gentleman takes what has been paid him in country outside of country, that's illegal, and that would have meant automatic termination under our agreement.

Mr. **Sikorski**. Well, if it's illegal, maybe General Electric can tell us why they approved that arrangement.

Mr. **Serrano**. It is not illegal to, as Baker & McKenzie advised us in 1978, because Yoon requested payment outside of Korea, but we refused to do that. The Baker & McKenzie people said that that can be done without violating the laws of Korea.

Mr. **Sikorski**. With the application approval by the Bank of Korea. That's what the——

Mr. **Serrano**. Yes. But, in my judgment, specifically what happened with Yoon, the fact that he received the money in country and then moved it without getting any kind of clearances is the potential illegality.

Mr. **Sikorski**. That's right. And the only way he can deposit it outside or move it, as you call it, is to get that approval.

Mr. **Serrano**. That's correct.

Mr. **Sikorski**. General Electric?

Mr. **Smith**. Well, our procedures for our whole international trading operation permitted the deposit of checks to the accounts of the consultant in the United States or in the country of the incorporation of the company.

Mr. **Sikorski**. Consistent or inconsistent with Korean law?

Mr. **Smith**. I am not aware of whether it was consistent or inconsistent.

Mr. **Sikorski**. Well, in referring to the documents that the gentleman of Oregon raised, Mr. Serrano, Mr. Yoon attempted to remove in the 1982 negotiations all requirements forcing the Buyeon Co. to observe U.S. laws, including the Foreign Corrupt Practices Act. You didn't allow him to do that?

Mr. **Serrano**. Absolutely not.

Mr. **Sikorski**. Well, why did he want to do that?

Mr. **Serrano**. I have no idea.

Mr. **Sikorski**. Well, did any other General Dynamics consultants ask to be waived from the Foreign Corrupt Practices Act?

Mr. **Serrano**. We do not tolerate that.

Mr. **Sikorski**. His request was unique then?

Mr. **Serrano**. I am not even aware of the fact that he requested exemption from that.

Mr. **Wyden**. Would the gentleman yield?

Mr. **Sikorski**. Sure.

Mr. **Wyden**. Let me just read you from your own memo. Yoon, in section paragraph 9 wanted some changes, and you all said, "We cannot drop this and show compliance with the Foreign Corrupt Practices Act."

Mr. **Serrano**. If I could see the document that you're referring to, Congressman Wyden?

Mr. **Wyden**. We would be happy to show it to you.

Mr. **Serrano**. Thank you.

Mr. **Sikorski**. While it is being brought down there, in those same negotiations, General Yoon attempted to exclude the termination clause, thereby guaranteeing his—kind of a no-cut contract. Your officials were concerned about this provision because, among other things, what if he—and I quote—"gets killed or goes to jail?"

Did you have any special concerns that he was going to get killed or go to jail?

Mr. **Serrano**. No, sir. We didn't want to have a contract with the organization, the Yoon organization, without General Yoon himself.

Mr. **Sikorski**. OK. Do you have that?

Mr. **Serrano**. Yes, sir.

This is a commentary written during the time when the company was trying to figure out how to break an impasse we had with General Yoon.

Mr. **Wyden**. Mr. Chairman, could I ask unanimous consent that the gentleman have one additional minute so I could follow up on this?

Mr. **Dingell**. Without objection, so ordered.

Mr. **Wyden**. Well, also, that memo that you have there goes on to say General Dynamics officials were concerned about other provisions because—and I quote here—"What if Yoon gets killed or goes to jail?"

Why would General Dynamics officials be concerned that General Yoon might be killed or go to jail? My colleague apparently asked that question.

[Pause.]

Mr. **Wyden**. If that has been asked, Mr. Serrano, if you could just briefly state it, if I missed that.

Mr. **Serrano**. Yes, I am trying to find that particular comment.

Mr. **Sikorski**. It's 10 June 1982, Buyeon's counterproposal to consulting agreement dated 1 March 1982.

Mr. **Wyden**. That is what you have.

Mr. **Serrano**. Yes, I am trying to find it.

Mr. **Sikorski**. Right. During a meeting with Ed Lane and Marlene Carver.

Mr. **Serrano**. I don't see who the source of this writeup is. It appears to be a memo to the file.

Mr. **Wyden**. Well, let's ask this again because my colleague asked it and I have asked it. Why were you all concerned that General Yoon might be killed or go to jail?

Mr. **Serrano**. That is unfortunate wording. I certainly don't recall why that question came up.

Mr. **Wyden**. Well, you must have thought he was doing something that might land him in jail or get him killed.

Mr. **Serrano**. We have absolutely no reason, no evidence, no reason to even think that, ever.

Mr. **Wyden**. You just put that in there about anybody who's working for you, they might end up in jail, might get killed?

Mr. **Serrano**. Well, I wish I knew who wrote this one-pager, because nobody seems to have signed up to it. I hope, if my memory is that faulty, I didn't write it but there's no addressee or signator.

Mr. **Sikorski**. Mr. Chairman, I understand that——

Mr. **Serrano**. I don't know.

Mr. **Sikorski**. Mr. Chairman, I understand that Ms. Carver is here. She was in that meeting. Maybe she has some indication as to whether there was any special concern.

Mr. **Dingell**. Is Ms. Carver in the room?

Mr. **Serrano**. Yes.

Mr. **Dingell**. Ms. Carver, after we finish with our current panel of witnesses, would you be available for further questions if we have need of your help?

Ms. **Carver**. Yes.

Mr. **Dingell**. Thank you.

The Chair observes that the time of the gentleman from Minnesota has expired, and the Chair recognizes now the gentleman from Texas, Mr. Bryant.

Mr. **Bryant**. Mr. Serrano, on June 10, 1982, you wrote a memo to J.R. Mellor. By the way, who is J.R. Mellor?

Mr. **Serrano**. Mr. Mellor is executive vice president of our commercial development and marine operations, and he was for some period of time, the executive vice president, international.

Mr. **Bryant**. Executive vice president of what?

Mr. **Serrano**. Of international and land systems, in 1983.

Mr. **Bryant**. Tell me again for the record what is your title?

Mr. **Serrano**. I am staff vice president, corporate offset operations.

Mr. Bryant. What is it about your job that has you here today? What is your area of responsibility that's caused you to come in contact with this situation?

Mr. Serrano. As mentioned—prior to stepping into this new assignment, I was director of international business development for the corporation, and had cognizance of our consulting agreements, with Mrs. Carver.

Mr. Bryant. All right. So at the time, on June 10, 1982, you were reporting with regard to these matters to J.R. Mellor in your memorandum. Is that right?

Mr. Serrano. That's correct.

Mr. Bryant. OK. In that memorandum of that date, you wrote that, "Yoon estimated that General Dynamics' compensation amounted to only about 30 percent of expenses incurred on behalf of General Dynamics."

Now, my question is, how could Buyeon have incurred expenses of more than three times what General Dynamics paid him over an 8-year period?

Mr. Serrano. I would like to see that document also so that I could refresh my memory.

Mr. Dingell. All right. Make copies of all these documents available to the witness.

[Pause.]

Mr. Serrano. This is the letter that Gorvine and I wrote to Jim Mellor. And this references the meeting that we had with General Yoon in Boston. What specific point, sir?

Mr. Bryant. Did you ask me a question?

Mr. Serrano. Yes. Yes, sir. What was the question?

Mr. Bryant. My question to you is, how could Yoon, or Buyeon, which is his company, have incurred expenses of more than three times what General Dynamics paid him over an 8-year period?

Mr. Serrano. The statement in the letter is, "Without having records with him, he estimated that GD compensation was 30 percent of expenses incurred in behalf of GD." That was an assertion on the part of General Yoon. And obviously, we didn't believe it.

Mr. Bryant. Well, December 15, 1981, a memorandum from Ron Craig to Takis Veliotis, he says, "A few comments on the attached regarding Buyeon compensation," No. 5 of which is, "General Yoon states that our compensation over the past few years doesn't begin to cover his expenses and that he has invested significant personal assets to ensure his country obtains the F-16."

[Pause.]

Mr. Serrano. That, once again, is an assertion by Mr. Craig.

Mr. Bryant. Well, what was your response to the assertion?

Mr. Serrano. I recall the phone conversation that I had with Mr. Veliotis because I worked for Mr. Veliotis. And he said that Mr. Craig was ill-advised and lacking foundation for his judgment of this. Mr. Veliotis expressed it rather colorfully.

Mr. Bryant. Well, what subsequent action did you take with regard to Mr. Yoon's requests?

Mr. Serrano. Denied them. In trying to determine a compensation package for him, we came up with our own internal best and final recommendation of $300,000 a year, and Mr. Lewis, when he finally got involved in that process, which was when he looked at the recommendation paper, said, "Cut it to 250."

Mr. **Dingell**. Would the gentleman yield?

Mr. **Bryant**. Yes.

Mr. **Dingell**. Did he say why he cut it?

Mr. **Serrano**. No, sir, I don't recall what his reasoning was for that.

Mr. **Dingell**. Was it an arbitrary judgment, or was it a judgment based on some factual information or a judgment based on the value of the services he had been providing?

Mr. **Serrano**. Mr. Chairman, I really don't know.

Mr. **Dingell**. Sounds like a rather arbitrary judgment when he says to cut it to 250. It sounds to me like he just figured, "Well, we will save $50,000." Is that true?

Mr. **Serrano**. I really don't know.

Mr. **Dingell**. The Chair thanks the gentleman.

Mr. **Bryant**. Well, who does know? I thought that was your area.

Mr. **Serrano**. You make a recommendation. You have a consultant who is obviously a very tough negotiator who wanted to negotiate about role and money on a continual basis. Our object, as we have mentioned to you, in July, was to stop any further administrative expense because we were opening our own office and we didn't want any more administrative contracts or negotiations thereof with General Yoon.

Mr. **Bryant**. Mr. Serrano, what was your relationship with General Yoon over in Korea? Did he use your telex number to communicate with his other clients? Where was he physically in relationship to the physical assets of General Dynamics in South Korea?

Mr. **Serrano**. I've been to the Buyeon offices two or three times, and in the time that we did not have our own office—we opened our own office about March 1983—we were colocated with him. And this was one of our concerns. All telexes to us, all datafaxes to us, went through his equipment, and he saw them first. And we just didn't think that was good business.

Mr. **Bryant**. Well, what about telefaxes, or whatever you call them, wires to him, did they come across your telex machine?

Mr. **Serrano**. No, not to my knowledge.

Mr. **Bryant**. From other clients?

Mr. **Sikorski**. Will the gentleman yield?

Mr. **Bryant**. Yes.

Mr. **Sikorski**. Mr. Serrano, I have seen documentation from you that internally General Dynamics gives credit to Mr. Yoon for the establishment of a separate General Dynamics office, that it was at his request and encouragement that you set it up to show the flag or the colors in Korea as you are going about the negotiation of his contract.

Mr. **Serrano**. My cognizance of his desire for us to have an office are most vivid in the 2-day negotiation that Mrs. Carver and I had with him, where we fought over that very point. He wanted us—he liked things the way they originally were. He didn't like the fact that we had our own office.

Mr. **Bryant**. Mr. Chapman, the reason I asked him the question is I have here a telex dated March 26—I don't see the year on it—

received March 27, 1981, which I believe is—it says, "Attention: Mr. D.R. Nelson." Is that one of your people?

Mr. **Chapman**. Yes, sir, that's the telex that was an attachment to Mr. Chafin's statement.

Mr. **Bryant**. Yes. And the reason I asked the question of Mr. Serrano was I noticed on that telex it says, "GE ENDYMIC," and it has a number, "J24762." Some type of a telex code, I suppose. Do you know what that is?

Mr. **Chapman**. I do not know what that number means, no, sir.

Mr. **Bryant**. Well, Mr. Serrano right next to you is taking a look at it. Would you take a look at it and tell me what that is? It's at the top and at the bottom of that Telex.

[Pause.]

Mr. **Bryant**. Is that your company's Telex code?

Mr. **Serrano**. I don't recall what our answer back is. Ours is usually GENDYN CLA.

Mr. **Bryant**. Why would a Telex sent to the United Technologies office bear the number and apparently the name of your company?

Mr. **Serrano**. In 1981, we didn't have our own offices, and Yoon had his own Telex facilities. We didn't have a Telex, to my knowledge, and I have no idea why anything with that kind of acronym would occur there. I really don't.

Mr. **Dingell**. Would the gentleman to the Chair?

Mr. **Bryant**. Yes.

Mr. **Dingell**. Let's try and get this. First of all, we have here a Telex from Buyeon Co. signed by E.Y. Yoon, and it says J24762. Apparently that is General Dynamics Telex code number or something or an address. Is that right?

Mr. **Serrano**. Mr. Chairman, we would have to check out from our other Telexes that we had received during that 1981 timeframe what this is. It is an anomaly. But I know we didn't have our own Telex facilities in Korea at that time.

Mr. **Dingell**. Well, you have got the committee somewhat confused. We are having trouble understanding it, too.

Mr. **Serrano**. We are confused about this.

Mr. **Dingell**. What I come up with here is an impression. Now, Mr. Chapman, you tell us that Mr. D.R. Nelson is one of United Technology's folks; is that right?

Mr. **Chapman**. Yes, sir. Mr. Nelson is an employee of United Technologies.

Mr. **Dingell**. Well, now. So we have Yoon sending, on General Dynamics Telex, a communication to Mr. D.R. Nelson at United Technologies; is that right?

Mr. **Chapman**. Mr. Nelson certainly is at United Technologies. This is a General Dynamics Telex number. I can't answer that. We do know it came from Buyeon Co. E.Y. Yoon to Nelson, UTC Hartford up at the top it says there. I don't know what this answer back means, this GENDYM J24762.

Mr. **Dingell**. It kind of looks to me like maybe Mr. Yoon is using General Dynamics' Telex to communicate with United Technologies. Is that a fair assumption?

Mr. **Serrano**. If there was—I just hope we didn't pay for the Telex machine and then he used it to service all of his accounts and didn't properly carve up who should have gotten charged for what. I just don't understand this. We will have to look into it. We will have to confirm it.

Mr. DINGELL. Of course I can share your concern that you are paying for a Telex here that you are not aware of, but I'm kind of curious: was this also charged to the U.S. taxpayers?

Mr. SERRANO. No, sir.

Mr. DINGELL. You say that rather quickly.

Mr. SERRANO. Yes.

Mr. DINGELL. Are you sure of that?

Mr. SERRANO. Yes.

Mr. DINGELL. You are sure? First of all, you don't know if you had a Telex.

Mr. SERRANO. I know that we did not have an office.

Mr. DINGELL. Once you establish that you don't know you have a Telex, how can you tell us that the cost of this Telex that you didn't know you had is not charged to the taxpayers?

Mr. SERRANO. Because the regulation effective March 1979, the new defense acquisition regulation, stipulated that effective March 1979, no foreign selling expenses could be allocated to United States accounts. And we told the United States Government that, although that was disputed and many other defense contractors and the United States Government felt that that regulation might be reversed, we went up-front with the United States Government and said: We are going to tag every one of our foreign selling expenses, we are going to tag them so that, if the judgment should go against allowability, then all of those items would be clearly visible and would be charged to actual foreign contracts.

And I can tell you that all of the offset, all of the consultant expenses, consistent with the DAR, are going to be charged to those foreign contracts, not to the United States taxpayer.

Mr. DINGELL. Was General Yoon's contract so tagged?

Mr. SERRANO. Yes, sir.

Mr. DINGELL. It was?

Mr. SERRANO. Consultant agreements are foreign selling expense. Now, from 1976 to about March 1979, the defense acquisition regulations permitted the allocation of that portion against all contracts.

Mr. DINGELL. After that time was that permitted under the DAR regulations?

Mr. SERRANO. No, sir; it was not. As I mentioned, we tagged those payments and told the United States Government: We are going to mark them so you know what they are, and if the ruling is made that they cannot be charged across the board, then we are going to charge them to the foreign contracts, which indeed is the way things are done.

Mr. DINGELL. Would you be very surprised if you found that there were a large number of these which were charged to the Federal Government?

Mr. SERRANO. If they were, they are to be reversed, and that is the position of our company, sir. They are not allowable or they are not chargeable to domestic contracts, to the United States taxpayer.

Mr. DINGELL. Is a foreign consultant's contract under the DAR regulations chargeable to the Federal Government?

Mr. SERRANO. No, sir. It's a foreign selling expense.

Mr. DINGELL. Well, now, we have testimony in the record here, I believe, from no less a person than one of the top officers of your company, indicating that these contracts with General Yoon were, in the period following the time that it was legal to do so under the DAR regulations, charged to—that General Yoon's contractual costs were charged to the Federal Government.

Now, tagging is very nice, but collecting on something that is tagged and is improper is not nice; and I'm trying to figure out what is going on here.

Mr. Lewis has indicated that the contracts of Buyeon and Mr. Yoon were chargeable, or rather were charged to the Federal Government.

Mr. SERRANO. My recollection was that he thought they might be.

Mr. WYDEN. And their progress payments.

Mr. DINGELL. You have even got progress payments on them.

Mr. SERRANO. I do not recall that testimony specifically. But I know because I have had this thing verified: that we took a cards-on-the-table position with DCAA and said let's mark these as foreign selling expense; it's an open issue as to the reversibility of that particular defense acquisition regulation. But it was not so ruled, and we can make sure that those charges are charged only to foreign contracts.

Mr. DINGELL. I find this very curious that here we have got a General Dynamics Telex used to communicate by Mr. Yoon with Mr. Nelson of United Technologies, and what I'm trying to figure out is why is this happening. It is your Telex. You tell us you didn't have a Telex during that time.

Mr. SERRANO. We had no office at that time, Mr. Chairman.

Mr. DINGELL. You had no office. Was he using, then, your office and your Telex for this purpose?

Mr. SERRANO. Wherever this Telex originated, and we are going to have to check it out, that's the first instance that I'm cognizant of that he could be using a machine that we may have purchased for one of our facilities to get this message out.

Mr. DINGELL. Are you telling me, then, that if he used your machines purchased for your facilities, that he was functioning out of your facility there at the place where this machine was located?

Mr. SERRANO. No, sir. I just don't know where this machine was located. We will have to check that out. But at the time, in 1981, we didn't have an office in Korea. We were using his facilities.

Mr. DINGELL. You were using his facility. Why did his facility have a General Dynamics Telex in it?

Mr. SERRANO. We had to have a Telex address. I don't know how the mechanics of that worked. I just don't know how those things worked, but we will find out.

Mr. DINGELL. Thank you.

The Chair apologizes to the gentleman. The Chair will extend the time of the gentleman.

Mr. BRYANT. Thank you, Mr. Chairman.

Mr. Chapman, getting back to the memorandum, I think the contents of it are as much of concern as the fact that General Dynamics apparently was providing, whether they knew it or not, Mr. Yoon with the ability to send you messages.

This Telex reads:

> With reference to outstanding payment due up to date, I hereby request you to bank transfer the total amount to the newly opened Buyeon Company, Ltd. bank account No. 0124081, First City Bank of Dallas, address, One Main Place, Dallas, Texas 75250. Meanwhile, I desire you to transfer all your payments to Buyeon through above-mentioned accounts in the future. I hope you will never advise or communicate us on your payment status. I shall check them from the bank statement. Your kind attention will be greatly appreciated. E.Y. Yoon.

What discussion, if any, was ever had in your company with regard to that interesting request that you never advise or communicate on your payment status to Mr. Yoon?

Mr. CHAPMAN. As you can see, Congressman, there is a question "Why?" with an initial, which is D.N., which is the addressee, Dave Nelson, and that question was: Why would we have a request like that? The discussion was that it appeared that Buyeon, with the number of business activities that he had in Texas, with the fact that he was representing G.D., which is located in Fort Worth, very close to Dallas, that it appeared that he may be wanting to consolidate all of his accounts in one Texas bank for his U.S. businesses.

Mr. BRYANT. Well, I think he chose the right city to do business in; no question about that. But my question to you, more to the point, is his request that you not—in fact, he said never: "I hope you will never advise or communicate us on your payment status." What did that mean?

Mr. CHAPMAN. I can tell you, with the amount of work that I have done internationally, especially with non-English-speaking countries, that quite often we have, going from literal to precise, a stilted translation. In this case we are not really sure what that meant, but we did see that that following sentence said that he would be advised by the bank statement that followed.

Mr. BRYANT. There is no translation involved here. This is English. What are you talking about translations for?

Mr. CHAPMAN. It is confusing English to me, sir. "I hope you will never advise or communicate us on your payment status." I really don't know what that means. And then he goes right on to say——

Mr. BRYANT. Well, with all due respect to you as an individual, I find that statement to be ridiculous, absolutely ridiculous, and typical of the way in which you guys come to this committee from time to time. The statement means this: I hope you will never advise or communicate us on your payment status. I shall check them from the bank statement.

Mr. DINGELL. Would the gentleman yield?

Mr. BRYANT. Yes.

Mr. DINGELL. Let's try and understand this, Mr. Chapman. Let's read this statement. It says: "I hope you will never advise or communicate us on your payment status." Now, that's a rather clear statement, isn't it?

Mr. CHAPMAN. That's clear when I take the second sentence, which says——

Mr. DINGELL. Let's stay with the first one now just for a little bit. It says: "I hope you will never advise or communicate us on your payment status." That means don't contact us on your payment status. Isn't that what he is telling us?

Mr. **CHAPMAN**. It is not necessary to.

Mr. **DINGELL**. Is he saying it is not necessary, or is he saying don't? It just says don't.

Mr. **CHAPMAN**. He says never, yes, sir.

Mr. **DINGELL**. Now, to resolve ourselves into a panel of semanticists, let's try and understand it. This is essentially mandatory.

Mr. **CHAPMAN**. Well, it's a request——

Mr. **DINGELL**. It says don't.

Mr. **CHAPMAN** It's a request from him, which we do or do not have to honor.

Mr. **DINGELL**. And then he says the reason that he has made the prior statement is I shall check them from bank statement. Isn't that what he is saying?

Mr. **CHAPMAN**. Yes, sir.

Mr. **DINGELL**. So he is saying don't send us any information on this, he will just get his information out of the bank statement? Isn't that what he is telling you?

Mr. **CHAPMAN**. Yes, sir.

Mr. **DINGELL**. OK. Thank you.

The Chair thanks the gentleman.

Mr. **BRYANT**. Well, what did you do after you got this memorandum?

Mr. **CHAPMAN**. As you can see, we asked the question "Why?"

Mr. **BRYANT**. Who did you ask the question "Why?" to?

Mr. **CHAPMAN**. The "Ed" which you see above that question "Why?" refers to a little higher up you see an E. Peters, Ed Peters at that time was responsible for United Technologies International's contract consultants.

Mr. **BRYANT**. What did Ed tell you?

Mr. **CHAPMAN**. Ed responded in a document, which I think we gave a copy—it is Number 102, sticks in my mind, which says that he supposed, he wasn't sure, but he supposed that it was to consolidate Buyeon's banking activities in Texas due to the fact that he had a relationship with possibly G.D., there were banking interests and it would facilitate that activity.

Mr. **BRYANT**. Well, we will find the memorandum and take a look at it, but I don't see what difference that makes. That's with regards to where you send his payments. I am asking you about this sentence, and let's stick with this, OK, because I'm going to run out of time, otherwise. "I hope you will never advise or communicate us on your payment status."

There is a little line on this memorandum in front of you that points right to that sentence, and it says, "Why?" Now, that doesn't relate in any fashion whatsoever to consolidating things, his money in Dallas. That's an instruction to you to "never advise or communicate us on your payment status. I'll check them from the bank statement."

Mr. **CHAPMAN**. Yes, sir.

Mr. **DINGELL**. Would the gentleman yield?

Mr. **BRYANT**. Yes.

Mr. **DINGELL**. Wasn't it also a fact, though, that his bank statements were sent to Paris?

Mr. CHAPMAN. Thanks to your subcommittee's work, we did find that out within the last 2 weeks, that they were sent there, yes, sir.

Mr. DINGELL. So Mr. Yoon doesn't want you communicating with him in Korea wih regard to his payment status. He wants that done through his bank statement, which he will check, but his bank statements are going to Paris.

Mr. CHAPMAN. Yes, sir, but we did not know where his bank statements were going. We would have no reason to think that they would not go to his place of business.

Mr. WYDEN. But the question is: Why didn't he want that stuff in Korea?

Mr. CHAPMAN. I can't answer why General Yoon——

Mr. BRYANT. Why didn't you ask him? Why didn't you call him on the phone and say: Why don't you want us to advise or communicate to you on your payment status like we would to anyone else?

Mr. CHAPMAN. There was no reason to.

Mr. WYDEN. If the gentleman might yield, it should have raised 45 red flags, Mr. Chapman, on the basis of that statement alone. That is what the committee is concerned with.

I appreciate the gentleman yielding.

Mr. DINGELL. The Chair observes that the time of the gentleman from Texas has expired.

Mr. BRYANT. Mr. Chairman, could I just ask one last question, briefly?

Mr. DINGELL. Yes.

Mr. BRYANT. Did you, after this memo was received by you, this Telex, did you advise him or communicate with him on his payment status in Korea?

Mr. CHAPMAN. No, sir.

Mr. BRYANT. You did not. You followed his request, then?

Mr. CHAPMAN. To the best of my knowledge, we did not.

Mr. BRYANT. Thank you.

Thank you, Mr. Chairman.

Mr. DINGELL. The time of the gentleman has expired.

The Chair recognizes the gentleman from Kansas, Mr. Slattery.

Mr. SLATTERY. Thank you, Mr. Chairman.

Mr. Serrano, in 1982, General Yoon asked General Dynamics to change its method of payment from wire transfer to a check delivered directly to the General. Now, why do you think he made this request?

Mr. SERRANO. As I recall his request, he said that he had been receiving his administrative fees—the administrative contract whereby he had been receiving those fees by check, whereas his retainer fee was by wire transfer. He said, as I recall, to simplify his accounting procedures.

Any time we send checks to these people, we send them a Telex and saying, we sent your check to you. He requested that these be sent to his office, DHL, and confirmed. Any method of payment change we generally run by our attorneys. This is a matter of routine. We got that cleared and did it. His rationale was to simplify his own accounting procedures, rather than receiving one payment by wire transfer and one by check.

Mr. SLATTERY. Well, Mr. Serrano, let me just point out an interesting observation here. When you look over the total amount of payments that General Dynamics made to Buyeon in 1982, General Dynamics paid this public relations operator or whatever you want to call him $658,000, which was almost twice what you paid him in 1981 and twice what you paid him in 1983.

Can you offer any explanation for why, at the time he was requesting a change in the method of payment, that your payment to him would double?

Mr. SERRANO. Recall we had been unsuccessful in finalizing the contract with him, 18 months, in fact, and the amount——

Mr. SLATTERY. You needed to spend a little more money to get the contract? Is that what you are telling me? That is your answer?

Mr. SERRANO. Retroactive payment is the reason for that larger check. It was retroactive, catching him up.

Mr. SLATTERY. What contracts were you competing for at that time, Mr. Serrano?

Mr. SERRANO. At that time in the 1981 timeframe we were really, to my knowledge, not competing for anything.

Mr. SLATTERY. Mr.Serrano, did it ever occur to you or to anyone else at General Dynamics that just perhaps this mysterious General Yoon may have been spending this money for some possible illegal purpose like bribing folks in Korea or——

Mr. SERRANO. Absolutely not, sir.

Mr. SLATTERY. It never occurred to you that there were any illegal payments involved to anyone?

Mr. SERRANO. No, sir. In fact, in the records that we gave to you yesterday, you will see 36 marketing reports, 297 pages that lay everything, all the cards on the table as how he saw the country, the prospects for us, actions we should take, actions he should take. Very professionally done. We had no reason to believe that any of these payments were used for improper use. We were shocked at the committee's discovery of that check being cashed outside of Korea.

Mr. SLATTERY. Well, you know, as a former businessman, when I would go over my expenses and I would see a doubling of an expense for 1 year, it would cause me to be a little bit concerned. I would wonder what was going on there.

I'm just wondering also, if you think it's just a coincidence that two weeks after General Dynamics began making cash payments to the General, that General Dynamics wrote a $220,000 check to the General that he took to Paris for deposit? Do you think that's just a coincidence? You see, that's almost all of this excess that I just referred to, or a big part of it.

Mr. SERRANO. I agree with you. I think it's very circumstantial. You know, it is a juxtaposition and it's circumstantial, but, in fact, we had a makeup payment for him. Recall that any of the larger amounts of money that he made were long after any F-16 decision, so there was no connection with that.

Mr. SLATTERY. Why would the General deposit that check in Paris, do you think?

Mr. SERRANO. I have no idea. As I say, we were shocked and we were outraged.

Mr. SLATTERY. Don't you think that's a pretty obvious way to avoid paying income taxes in Korea, and isn't that a violation of Korean law?

Mr. **Serrano**. That's a possibility. In fact, because we paid the money to him in country and because he took the money out of the country and apparently didn't have authorization, by our contract that is an automatic termination.

Mr. **Slattery**. Mr. Serrano, I have a telegram from a General Dynamics vice president, Mr. Otto Glasser. Do you know Mr. Glasser?

Mr. **Serrano**. Yes, sir.

Mr. **Slattery**. That says that General Yoon unlawfully cashed sizable General Dynamics checks in Paris, to quote from the memo. Do you agree with that statement?

Mr. **Serrano**. If he is referencing the revelation that came as a result of the committee's work, yes, that's a possibility, that it was illegal. I say possibility. I don't know what Yoon actually did, whether, in fact, he may have applied to the Government for a clearance. I just don't know.

Mr. **Dingell**. Would the gentleman yield to the Chair?

Mr. **Slattery**. I would be happy to yield to the Chair.

Mr. **Dingell**. The contract with regard to the F-16 with the Republic of Korea was signed when—was it in 1981?

Mr. **Serrano**. The LOA, I recall, was signed in 1981, sir.

Mr. **Dingell**. 1981. So these events are reasonably contemporaneous with the dates of the signing of the LOA; is that right?

Mr. **Serrano**. With regard to the signing of the LOA but not with regard to the signing of the bilateral agreement.

Mr. **Dingell**. All right. Now, when was that done?

Mr. **Serrano**. The bilateral agreement, according to the Ministry of Defense of Korea, was in 1974.

Mr. **Slattery**. When was the F-16 transaction consummated?

Mr. **Serrano**. The LOA was signed by the Government of Korea in 1981, but there was no question but that——

Mr. **Slattery**. What time of the year?

Mr. **Serrano**. As I recall, it was toward the end of the year.

Mr. **Dingell**. The LOA had to be signed before any money started moving toward General Dynamics; isn't that right?

Mr. **Serrano**. That's correct.

Mr. **Dingell**. OK. What is the difference between the bilateral agreement and the LOA in terms of events that went to the sale of the F-16? Did the bilateral agreement in any way bind the Republic of Korea to buy any particular aircraft?

Mr. **Serrano**. The agreement in principle, Mr. Chairman, the agreement in principle reached by the U.S. Government, by Secretary Brown and by the Government of Korea as early as 1974-75 was, yes, you will get the F-16, and at that time, in principle they talked about Secretary Brown indicated that he accepted in principle the request of the Korean Government for 50 F-16's, and that was confirmed in the security consultative meeting in '1978, I believe, and that was a done deal.

Mr. **Dingell**. No, an agreement in principle is not a done deal. An agreement in principle is an agreement in principle. In other words, it is a general agreement to which neither party is really fully or firmly bound. An agreement in principle says that we agree in principle with these statements, but it doesn't mean that anything necessarily is going to happen. It means that it has to be cemented in place by further agreements which deal with the specifics.

Now, is that not true?

Mr. **Serrano**. Yes.

Mr. **Dingell**. So the LOA was, in fact, the specific deal which culminated in the transfer of F-16's to the Republic of Korea and in a transfer of cash money to General Dynamics; is that not so? And none of these other documents prior had anything to do with those facts. They were agreements in principle which, in fact, were negotiating steps which led up to the transfer of aircraft and the transfer of cash, the aircraft going to the Republic of Korea and the money coming to the U.S. contractor, General Dynamics. Isn't that a fair statement?

Mr. **Serrano**. That's a fair statement, but it's also——

Mr. **Dingell**. And any other interpretation of the events that transpired prior to that time is really not correct.

Mr. **Serrano**. Except the decision document of the 706 Committee, which was a total evaluation and procurement plan for the F-16.

Mr. **Dingell**. But that is a procurement plan; that is not a contract which, in effect, binds General Dynamics to deliver aircraft or binds the Republic of Korea to deliver money to General Dynamics.

Mr. **Serrano**. Unless a competitor——

Mr. **Dingell**. The LOA is the document which does that.

The Chair observes that we are going to have to recess for a little bit. I suspect everybody would be kind of glad if we do. No, I guess we don't have to. The Chair is going to request the gentleman from Oregon to assume the Chair, and the Chair is going to go and vote.

Mr. **Slattery**. I am going to join the Chair in going to vote, but I would like to ask one last question and then I will come back.

The bottom line of what we are saying is that the F-16 transaction with Korea was consummated in 1981 with respect to the delivery of the F-16's. That's what we are saying.

Mr. **Serrano**. We are saying the LOA was signed.

Mr. **Slattery**. That's the bottom line deal. That's the signed deal. That means you are going to deliver some aircraft, and that was done in 1981. And in 1982, a few months later, we now know that a $200,000 cash payment was made to this General Yoon and it was transferred to Paris.

Now, that should have raised a red flag for someone within General Dynamics. I mean those are the basic irrefutable facts.

Mr. **Serrano**. And it did.

Mr. **Slattery**. And for someone to sit there and say, Mr. Serrano—and you know, I have had an opportunity to get acquainted with you folks now over the last few years, but for someone to sit there and say, you know, we just didn't suspect anything, I don't buy it. I wish I could.

I am going to be back in a few minutes to follow up. I have some more questions for you.

Mr. **Wyden** [presiding]. Mr. Serrano, we have another memo, from General Dynamics employee F.F. Gurr in your Seoul office dated March 14, 1985. In this memo Mr. Gurr explains his frustration in trying to deal with the Korean Air Force without General Yoon's assistance, and it seems to me, Mr. Serrano, that, based on this letter, that General Dynamics is almost totally dependent on General Yoon to make the contacts to the Korean Air Force. Is that correct?

Mr. SERRANO. That is not correct, sir. In fact, as mentioned in my statement, we had a long-term, growing clash with General Yoon, and one of them was over that specific incident, where we requested General Yoon to arrange a meeting and he said he could not arrange the meeting with the Air Force, and these are technical people, colonel-level people. We found out later that in fact he had visited with the colonel that we wanted to visit with ourselves, and in fact he had had that colonel say to us that we should only set up meetings through him. We said, we are not going to buy it.

Mr. WYDEN. Well, why would Mr. Gurr say that I am a very tired person and nearly out of patience with the whole situation?

Mr. SERRANO. With that specific situation. And in fact, the reason he was frustrated was because he had an agreement with General Yoon that if he made a request of General Yoon to set up this meeting for this Fort Worth team, that General Yoon would go and arrange these meetings with these working colonel, technical kinds of air force people. In fact, General Yoon refused to accept that request from Mr. Gurr and, in fact, said give it to me in writing. And, as I recall, he did, and General Yoon said that's not good enough, I want to talk to the next level up.

It is that type of clash and a larger role that he wanted, evidenced by that type of clash over which we said: we have had enough of this kind of thing. And then, of course, the revelation about the check, and we said: that's it, no more.

Mr. WYDEN. Well, do other contractors need a consultant in order to meet with Korean Air Force officials?

Mr. SERRANO. Korea is a very difficult country--very protocol oriented. In dealing with the Korean Air Force, for example, if you don't have clearance to be in a specific room for a briefing to cover specific materials that is not duly noted in your application, that constitutes a career-limiting security violation in the Korean Air Force. You have to have someone cognizant of that protocol to assist you in working with virtually all of the branches of the Korean armed services.

Mr. WYDEN. Well, let me ask if the other contractors need a consultant to meet with Korean Air Force officials. Mr. Chapman?

Mr. CHAPMAN. Yes, sir.

Mr. WYDEN. Mr. Fish.

Mr. FISH. Sometimes you do; sometimes you don't. It facilitates things. I found you can get appointments at times without them, but it is a facilitating thing.

Mr. WYDEN. Mr. Smith?

Mr. SMITH. I think our answer, experience is the same as Mr. Chapman's.

Mr. WYDEN. Mr. Peterson?

Mr. PETERSON. I would say it is a facilitator.

Mr. WYDEN. Mr. Serrano, it seems to us on the subcommittee that General Dynamics is extraordinarily dependent on General Yoon to make any progress in Korea, and that is why the company accommodated General Yoon's every request, every single request, including cash payments that violated the law.

Now, what other explanation could there be? Give us a plausible alternative explanation.

Mr. SERRANO. Of what, specifically? I want to be sure I understand your question.

Mr. WYDEN. Well, it appears to us that General Dynamics is very dependent on General Yoon and has gone along with every request that he made, including the cash payments, cash payments that violated the law. What other explanation——

Mr. SERRANO. Congressman Wyden, we had some very difficult times with General Yoon precisely because from the beginning, we wanted no violation. He wanted to be an agent—that was what he was accustomed to—during the 1974 period, and we said absolutely not.

You will find in the records that we gave to you the trip report of General Glasser where in March 1975, which was the first time that we had an exposure to Yoon, Glasser told him: your fee is going to be $100 a day to $125 a day, and maybe we will use you for 15 days—and his note says yes, that's what Yoon agreed to—and under no circumstances would we have any kind of agent or commission relationship with you. And we fought tooth and nail over that.

We simply would not accept Yoon in any kind of marketeer role, and that was a problem because we set up our own office in 1983, we had a program office for a tank program in Chang Won a year and a half or 2 years ago, and we established a program office for the F-16 program.

We now have three presences in country and we have less dependence on consultants, and we have told our consultants: consultant role, period, the end.

Mr. WYDEN. Well, we have a General Dynamics memo that was dated April 10, 1985, that discusses cash payments to Buyeon, apparently out of the General Dynamics Tokyo. Why would a multinational corporation like General Dynamics resort to cash payments?

Mr. SERRANO. As I believe I mentioned earlier, Congressman Wyden, we, in the early days, not in 1985 but in the earlier days, I do recall—and Mrs. Carver would probably be aware of the detail of this—that Mr. Durr may have reimbursed General Yoon out of the Tokyo office for administrative expenses. I think we would estimate that that would be a maximum $50,000 that he signed receipts for and for which he provided invoice documentation.

Mr. WYDEN. Well, that was done in 1980.

Mr. SERRANO. I would have to see the transactions. As I say, yes, there were some of those.

Mr. WYDEN. Well, are you authorized to give cash to consultants?

Mr. SERRANO. For administrative expenses that are for actual expenses incurred, and they are variable, there were provisions in this administrative support contract where on a receipted basis, those could be paid.

Mr. WYDEN. Well, I find it very unusual that a company like General Dynamics, that certainly ought to be aware of the Foreign Corrupt Practices Act, would be making cash payments overseas knowing full well that that cash might be used for bribes.

Mr. SERRANO. In effect, we were cashing his check.

Mr. **Wyden**. This is in 1980.

Mr. **Serrano**. In effect, we were cashing his check, Congressman. The guy had invoices—I really can't conjecture. I don't know the specific transaction.

Mr. **Wyden**. The gentleman from Texas.

Mr. **Bryant**. Well, what do you mean, in effect you were cashing his check. Did you issue a check to him and he said, would you help me out by cashing it for me?

Mr. **Serrano**. We may have done that.

Mr. **Bryant**. Well, did you or didn't you do it? Don't suggest you did it if you don't know. Did you do it that way or not?

Mr. **Serrano**. Well, I thought we were talking about this specific transaction. On that specific transaction, I just don't know.

Mr. **Bryant**. How much cash did General Dynamics give to General Yoon?

Mr. **Serrano**. As I said, these kinds of transactions, where he would present a receipt for actual administrative expenses, probably totalled to something on the order of $50,000, paid through the Tokyo office, and then that was stopped. It was highly unusual because, as we said, we went to the lawyers in the very beginning, and in fact, we redid the contract precisely so we could pay the guy at a legal entity in Korea.

Mr. **Bryant**. But the fact is that this was caught by an internal audit, wasn't it? It's not a matter of you deciding not to do it any more. It was caught by an internal audit.

Mr. **Serrano**. No, it wasn't caught by an internal audit. It was an initiative in our part in 1978.

Mr. **Bryant**. Well, you made the last payment in March 1980. I am reading from a memorandum to G.A. Sawyer from M.E. Carver, subject: Cash payments to Buyeon.

> While it does not detract from the importance of not paying for any item or service with cash, we do have documentation signed by E.Y. Yoon which shows that he received three cash payments. Copies of that documentation are attached. The last such payment was made in March 1980.

Mr. **Serrano**. The only thing I can say is that is Mrs. Carver doing her job, stopping that kind of—finding that kind of——

Mr. **Bryant**. Well, that's an interesting observation, but that's totally beside the point. The point is it clearly contradicts what you just said about not having done that since 1978.

Mr. **Serrano**. No, for 1978 I was referencing our initiative to work with Baker & McKenzie to make sure that we were paying a legal entity in Korea.

Mr. **Bryant**. Well, then that answer was as well an irrelevant answer to the question I had asked before.

Mr. **Serrano**. No, it is relevant to the point, sir, that we have gone out of our way to be aggressive in enforcing the spirit and intent of the Foreign Corrupt Practices Act.

Mr. **Bryant**. Well, I think that you are being quite deceptive with us. That is my opinion of what you have done here in the last 5 minutes.

You suggested that somehow you had decided as a matter of policy not to do things that might look bad or violate the Foreign Corrupt Practices Act, and so you stopped these cash payments; but the memorandum here, the second part of the paragraph says,

> The method of paying for consultant services was addressed in an internal audit report dated August 1980, wherein Tokyo and Seoul office records have been reviewed in St. Louis and in country, and the recommendation is payment for goods and services should be made only to the individual or firm with whom we have agreed to do business and directly transmitted only to his legally established address.

The point of the matter is an internal audit caught this thing; you didn't make a decision not to give him cash anymore until an internal audit caught it and suggested that it was the wrong way to handle your money. So that contradicts what you said just a moment ago with regard to your virtuous intent.

Now, you also made a comment just a moment ago that you were, in effect, cashing his checks. The reason I'm zeroing in on that is I don't like it when you throw out these little figures of speech that throw everybody off here. You didn't write a check that he then submitted to you and then you cashed, did you? You just paid him in cash, didn't you?

Mr. SERRANO. I don't know.

Mr. BRYANT. Then why did you say that you were, in effect, cashing his check?

Mr. SERRANO. Because there may have been an instance that I have in mind in Tokyo where we provided a reimbursement check for documented administrative invoices. I'm not certain of that.

Mr. BRYANT. Then why would you throw that out as if—if you are not certain of it and there may have been instances and you can't remember, why do you throw out that as an answer? You didn't go cash a check; you paid him in cash. Isn't that correct?

Mr. SERRANO. I don't know.

Mr. WYDEN. Would the gentleman yield?

Mr. BRYANT. Yes.

Mr. WYDEN. I appreciate the gentleman yielding.

There is a memo to Mr. Sawyer from Mr. Trise. "While it does not detract from the importance of not paying for any item or service with cash, we do have documentation signed by E.Y. Yoon that he received the three cash payments."

Mr. SERRANO. I said that we did pay him cash payments that probably totaled $50,000, and that——

Mr. WYDEN. But you just said he got it by check.

Mr. SERRANO. Well, I'm saying in one instance, Congressman, there may have been one instance, and Congressman Bryant's point is well taken. I'm telling you I don't remember that specific incident. Let me qualify my statement.

Mr. SLATTERY. If the gentleman would yield, we are playing a game of obfuscation here again. I mean, the memo clearly says: "10 April 1985, subject: cash payments to Buyeon. Cash payments."

Mr. SERRANO. Yes.

Mr. SLATTERY. What are we talking about? I mean you paid the man in cash, did you not, Mr. Serrano? Yes or no? Yes or no, Mr. Serrano? Here is a memo from your company——

Mr. SERRANO. Yes, the $50,000——

Mr. SLATTERY. Is that yes in response to my question? Did you pay the man in cash or not? Yes or no? I assume your "yes" was in response to my question; is that correct?

Mr. SERRANO. Yes.

Mr. **Slattery**. Thank you, Mr. Serrano.

Now, let me just make a point here, if I could. We have wasted a lot of our time in beating around this bush, Mr. Serrano. This reminds me a little bit of the conversations that I had here in this room with one of the previous chairmen of the board of General Dynamics who also played this beating around the bush game.

Let's not waste each other's time. When the gentleman from Texas asks you a simple question, why don't you save your time and all the people at the table's time and our time by responding very simply to a very simple question.

Mr. **Wyden**. We are going to let the gentleman from Texas continue, but Mr. Serrano, have you ever paid any other consultants in cash, now that we have established Mr. Yoon has gotten some cash?

Mr. **Serrano**. We have paid our consultants in wire transfers and by check, and we may have paid some documented administrative expenses, but I can't think of any other instance where we paid them in cash.

Mr. **Slattery**. Would the gentleman from Texas yield?

Mr. **Bryant**. Yes.

Mr. **Slattery**. Let me ask the other gentleman——

Mr. **Wyden**. If the gentleman will just let me follow up. Did Lilly Durr ever get any cash payments?

Mr. **Serrano**. I don't know. It was our custom to pay her by check.

Mr. **Wyden**. She is the wife of George Durr, and perhaps Marlene would know.

Would you like to come forward and answer the question?

Let the record show Ms. Marlene Carver has been asked to come forward.

We will have to swear you, Ms. Carver. Do you have any objection to being sworn?

Ms. **Carver**. No, I don't.

[Witness sworn.]

Mr. **Wyden**. Let me also advise you that you have the right to counsel and the right to a copy of the committee's rules with you at all times throughout your appearance today.

Could you answer the question that I asked Mr. Serrano about Lilly Durr?

TESTIMONY OF MARLENE CARVER

Ms. **Carver**. To my knowledge, she hasn't received cash payments.

Mr. **Wyden**. To your knowledge, she has not received any cash payments?

Ms. **Carver**. That's correct.

Mr. **Wyden**. Are you aware of an internal company memorandum that would indicate that she has received cash payments?

Ms. **Carver**. No.

Mr. **Wyden**. We will go on from there.

Does the gentleman from Texas wish to pursue any additional questions?

Mr. **Bryant**. Yes, but I yield briefly to the gentleman from Kansas.

Mr. **Slattery**. I thank the gentleman. I am trying to get my 5 minutes in from earlier.

I would like to ask the other panelists: Do your companies make cash payments to consulting firms internationally? Mr. Smith? Let's just go down the table, if you would. Just yes or no.

Mr. **Peterson**. No, sir. It is our practice not to.

Mr. **Slattery**. Have you ever?

Mr. **Peterson**. Not to my knowledge.

Mr. **Slattery**. Mr. Smith?

Mr. **Smith**. I'm not aware of any cash payments being made.

Mr. **Slattery**. Ever?

Mr. **Peterson**. Never. I'm not aware of any being made.

Mr. **Slattery**. Mr. Fish?

Mr. **Fish**. No.

Mr. **Slattery**. Ever?

Mr. **Fish**. Not to my knowledge.

Mr. **Slattery**. Mr. Chapman?

Mr. **Chapman**. No, sir.

Mr. **Slattery**. I just wanted to establish this. Does it make you feel a little bit uncomfortable, Mr. Serrano, that all your competitors here do business and pay their consultants in ways other than by cash? Don't you think it points out a rather unique method of payment?

Mr. **Serrano**. The record indicates that Yoon presented invoices and we paid them, and I had said that we paid them, sir.

Mr. **Bryant**. Mr. Serrano, we have another memo here dated April 8, 1985, that indicates General Yoon asked Mr. Veliotis for $5 to $6 million in 1981 and 1982, and that Mr. Veliotis has the conversation with General Yoon on tape. Would you explain the entire situation and explain why in the memo you advised General Yoon to get a lawyer, or why after the memo was written you advised General Yoon to get a lawyer?

Mr. **Serrano**. I am trying to recall the content of that——

Mr. **Bryant**. It begins: "I'm calling because I am still a loyal member of GD's family. I tried to call but they all close their doors to me."

Mr. **Serrano**. If I could see that. You recall that Mrs. Carver and I went to a great effort to try to make available all of our records to the committee and spent a couple of days with you folks.

[Witness examining document.]

This is when Yoon called me——

Mr. **Bryant**. I am just asking about, down at the bottom of it, why you advised Mr. Yoon to get a lawyer and what the situation was that precipitated this memorandum.

Mr. **Serrano**. What precipitated this—as I mentioned, we had this building confrontation with Yoon over Yoon's role that he wanted for himself. He wanted to be an agent. And he knew that sooner or later we were going to end up. We had that March 19 meeting where we drew the line and said, look, you are going to operate as a consultant, not as an agent, and he had threatened legal action, and while we were in this cooling off period, I am not going to advise General Yoon what he should do as to any action that he might want to take against General Dynamics, and I said, my only advice to you is I can't help you, you ought to go talk to your lawyer, or a lawyer.

Mr. **Wyden**. Does the gentleman have additional questions?

Mr. **Bryant**. Yes, I do, but this gentleman would like to ask a few.

Mr. **Slattery**. I would just like a point of clarification. What is the difference between being an agent and being a consultant? Can you clarify the distinction? Does it have anything to do with the method by which the gentleman would be paid?

Mr. **Serrano**. An agent, as we use the term, means you get a sales commission on anything that you sell. It's a direct sales relationship. Our clash with Yoon was that Yoon wanted to be the only marketeer, the sales agent for General Dynamics, and we said no, that's not the way we can do business. Our sales are primarily government to government FMS, and we do a different kind of marketing. We don't peddle. We have to work with our government because our sales are an extension of the foreign policy of the U.S. Government. That's how we have to operate. We cannot get commissioned agents involved, and we don't want to.

Yoon wanted that relationship. We said no.

Mr. **Slattery**. We had testimony earlier today that one of the other panelists, I believe, did pay a commission of some $200,000 to—who was that?

Mr. **Serrano**. That's valid. That's commercial business.

Mr. **Slattery**. Is that you, Mr. Chapman?

Mr. **Chapman**. Yes, sir.

Mr. **Bryant**. Mr. Serrano, we have another memorandum that makes reference in it to the fact that General Yoon is afraid to return to Korea because he will be tortured. Can you explain this?

Mr. **Serrano**. You are referring to the summary of events written up by Mr. Durr May 7.

Mr. **Bryant**. Tuesday, May 7, 1985.

Mr. **Serrano**. And he had a meeting with Yoon on March 27. He said: "He has always had a good reputation in Korea as he has never caused or been involved in any situation that would cause problems for people in government, but he is afraid that—that is Yoon's perception." And you know, he contradicts himself in the next paragraphs. He says he didn't do anything wrong. He says because he has always been Mr. Good Guy: "Everyone in Korea believes he received a commission from GD . . . there are many people after him to support them or their organizations. By fighting our enemies in the government, he created enemies who are out to get him."

Here is a man who has had all this adverse publicity in the press. It has come to light that he is cashing checks outside of Korea. If, indeed, he has violated Korean law—if I were a Korean, I would be very concerned—and that is obviously what he is expressing here.

That's my opinion, OK?

Mr. **Bryant**. Well, is he expressing an opinion that he is going to be caught, that they have got the goods on him and he can't go home?

Mr. Serrano. He said he has never done anything except he has been successful and he has got enemies. He is a very troubled man, obviously.

Mr. Bryant. One last question I would like to ask you. That first memo I mentioned was April 6, I think, and that happens to be right after the first hearings we had in here with General Dynamics with Mr. Lewis present and others where we played tape recordings with Takis Veliotis and so forth. Why is it that suddenly you terminated your relationship right after those hearings? In fact, all of you did that. I think it is very curious. Except for LTV.

Mr. Serrano. Mr. Bryant, in my opening statement—we didn't do that. This was a long time building, and——

Mr. Bryant. Do you expect us to believe that you didn't terminate that relationship with him right after that hearing—I mean that you terminated it right after that hearing just coincidentally because you had a long-time buildup of a problem with him?

Mr. Serrano. March 19, we had a very heavy meeting with General Yoon. We had him in, and we tried to make a serious effort to work with him in the role of a consultant. As I said, he wanted to be a commissioned agent. We really tried to work hard with Yoon. He was out of Korea. He wasn't providing services and we had a team in country that was giving presentations to the Air Force. Then, after trying to work with him, our Pomona division brought to our attention the fact that Yoon wrote to them to sell their products on a commission basis. We said: That is the last straw, it is never going to work.

On March 19, we had reached the conclusion in our own minds to get rid of him, and yes, the last straw was, when it came to light, on top of the difficult working relationship, that he had taken money outside of Korea that we sent there. It certainly was a factor. And it occasioned us to do a total revamp and a look-see at what happens to checks to consultants.

Mr. Bryant. I would just observe that life is certainly full of many strange coincidences in the ongoing drama of General Dynamics and its inner workings. I find that to be totally incredible. I don't believe your statement.

Mr. Wyden. The gentleman from Kansas is recognized.

Mr. Slattery. I would just observe, to kind of complete the circle on your statement, Mr. Serrano, that you and your company certainly made it easier for Mr. Yoon to do what he did by paying him in cash, and I don't think there is any question about that. Now, what he did with the cash after he received it was certainly his business, but I would observe that a cash payment certainly made it much easier for Mr. Yoon to do what he ultimately did in violation of Korean law.

Would you agree with that, Mr. Serrano, that a cash payment of $200,000 a few months after he was instrumental in procuring a very important agreement with the Korean Government with respect to the sale of the F-16 made it very easy for Mr. Yoon——

Mr. Serrano. We didn't pay him $200,000 in cash. We paid $220,000 November 22, 1982, DHL, with Telex notification that it went to Korea, and that has nothing to do with——

Mr. Slattery. The fact of the matter is, Mr. Serrano, a few months after your company, General Dynamics, completed an agreement with the Korean Government that Mr. Yoon was instrumental in procuring regarding the F-16, a cash payment was made in the amount of approximately $200,000, which Mr. Yoon could certainly use in the way that he did. That, in effect, enabled him to avoid paying perhaps taxes in Korea and putting the money in a Paris account or whatever.

Mr. SERRANO. Mr. Slattery, I beg to differ that those are not the facts. The check was for $220,000. It was DHL'ed. We confirmed that it was DHL'ed to him in Korea. There were no cash payments, and he was not instrumental in selling the F-16.

Mr. SLATTERY. Then why did you make him a payment of $200,000 if he wasn't instrumental in selling it? And the facts are that you did, Mr. Serrano, pay him a check in Korea, he went to Paris and cashed it. There is no question about that, and it was done a few months after he was involved in the sale of the F-16's, and I assume, being a good businessman that I assume that you are, Mr. Serrano, you paid him for services rendered. You didn't just make a charitable gift to the man.

Did you pay anybody else over there anywhere near $200,000 for helping you get this contract? Did you?

Mr. SERRANO. No, sir. As the records indicate——

Mr. SLATTERY. Then I assume that he was instrumentally involved in getting the contract, in getting the deal, or you wouldn't have paid him that enormous amount of money.

Mr. WYDEN. Would the gentleman yield?

Mr. SLATTERY. I would be happy to.

Mr. WYDEN. Did you ever turn these checks over to see where they were being negotiated, Mr. Serrano?

Mr. SERRANO. Congressman Wyden, we did after it was brought to our attention by the committee. We made a special request to go to that part of the company that receives those checks, and we looked through 60,000 checks. We hired people to go do that.

It was a separate part of the company that receives canceled checks.

Mr. WYDEN. But don't you think that should have been done when the change was requested to go from wire to check?

Mr. SERRANO. That was a 5- to 7-month period that he made that request, and he requested that the payments go back to wire, which they did, and we had no reason—there was not enough of a blip on the screen to——

Mr. WYDEN. He didn't. One of his assistants did, and he did because he was running out of money.

Mr. SERRANO. Well, I don't know why it was done, but there was a request to return to wire transfer.

Mr. WYDEN. We think there is evidence that Mr. Yoon was taking it all to Paris.

Mr. SERRANO. Well, he took a lot to Paris, as is evident, that we now know, and hindsight—yes, we would have gone back——

Mr. WYDEN. In hindsight you would have done it differently?

Mr. SERRANO. Sure.

Mr. WYDEN. Let me ask you about a question that the chairman pursued with you, and that is a request of billing expenses for foreign consultants to the Government. We have a DCAA Audit Report No. 3201 done for the calendar year of 1982, and we indicate significant expenses for foreign consultants were being billed to the Government at that time. That was 3 years after the changes that you were talking about had been made.

Are you aware of that?

Mr. **Serrano**. My understanding is, we told the Government that we are going to bill you for these, we are going to tag them as separate. And if the ruling is that they are not allocable to all contracts, they are identified, on the table, and we are going to charge them to the foreign contracts.

Mr. **Wyden**. But in fact you were getting progress payments on all these, weren't you?

Mr. **Serrano**. I don't know whether 1982 was settled. Was it? I just don't know.

Mr. **Wyden**. But you were being paid, were you not?

Mr. **Serrano**. I don't know.

Mr. **Wyden**. A little while ago,though, you said you were not charging the Government. Now that we have produced the DCAA audit report that indicates the Government was being charged, you say you don't know any more. Which is it?

Mr. **Serrano**. It is that we told the Government what was foreign selling expense. We said when there was a ruling, and if there was any dispute, we certainly would not charge the U.S. taxpayer.

Mr. **Bryant**. Mr. Chairman, would the gentleman yield just a little?

Mr. **Wyden**. I would be happy to yield to my colleague.

Mr. **Bryant**. In response to your question a moment ago, Mr. Serrano said that these check payments were only made over a 4-month period, I think.

Mr. **Serrano**. Seven-month. November to May.

Mr. **Bryant**. OK. Now why do you recall so specifically that 7-month period?

Mr. **Serrano**. I recall the 7-month period because Mrs. Carver and I just spent 9 hours with your committee, and we took the opportunity to apprise ourselves of the various files, and to make sure that your committee was provided all those materials.

Mr. **Bryant**. Well, I have been provided those materials and those checks run from 1982 through 1983, as late as December of 1984.

Mr. **Serrano**. Administrative support checks.

Mr. **Bryant**. That's not what the committee staff thinks.

Mr. **Serrano**. Two agreements. Administrative support, which we wanted to eliminate with the new contract, and the retainer fee.

Mr. **Bryant**. I don't think it makes any difference if the moneys are still ending up in Paris. What is the difference, what your bookkeeping shows? You are still sending checks instead of wires.

Mr. **Serrano**. We are sending checks and we are confirming that the checks were sent, and we are DHL'ing them to Korea, and we had no reason to believe that they weren't being properly negotiated by——

Mr. **Bryant**. What does that mean, DHL'ing them to Korea?

Mr. **Serrano**. That's an express service that the thing left the United States and it would be delivered in an expeditious manner, usually 2 to 3 days, to the foreign location.

Mr. **Bryant**. Excuse me, Mr. Chairman, for interrupting, or Mr. Wyden. I just wanted to make the point. You didn't just send checks over a 4-month period, you sent them over a 3- or 4-year period. You want to distinguish between one type of payment and the other. I don't see what difference it makes. The guy's getting the money in a form that allows him to move around the world.

Mr. **Serrano**. I thought your question, sir, was with regard to the change in method of payment that we made, the specific one regarding the $220,000 and why we did make that change. I was responding to that question.

Mr. **Bryant**. You weren't intending to tell the committee that you didn't write checks except during the 4-month period.

Mr. **Serrano**. The original question, I believe, sir, was—why did you stop going wire transfer to pay that retainer fee by check, and that is what I was trying to answer.

Mr. **Wyden**. One last area that we are interested in exploring with you, Mr. Serrano, both Arnold Glasser and Edward Ward claim General Yoon and/or Buyeon may have violated the laws of Korea with his French bank deposits. Do you share that view?

Mr. **Serrano**. It is my understanding that if he did not have proper clearance to do that—to declare that transfer of money—just as in the United States, that is a violation of currency law.

Mr. **Wyden**. Well, the question, then, for each of the other companies is, given that, why did you pay Mr. Yoon outside of Korea?

Mr. Chapman, why don't we begin with you?

Mr. **Chapman**. Sir, we did not know that that was a law and, therefore, as far as U.S. law, we were paying——

Mr. **Wyden**. I'm sorry, you said you didn't know that was a law? Shouldn't you know what the law is?

Mr. **Chapman**. No, sir.

Mr. **Wyden**. You shouldn't know what the law is?

Mr. **Chapman**. In Korea? This is a Korean law we are talking about; is that right, sir?

Mr. **Wyden**. Well, sure. You're doing business there.

Mr. **Chapman**. Yes. What we did, sir, was make sure that we were operating under appropriate correct U.S. law, and U.S. law, the Foreign Corrupt Practices Act, allows us to pay in that manner.

Mr. **Wyden**. The other companies we would be interested in, Mr. Fish.

Mr. **Fish**. Excuse me, sir.

Mr. **Wyden**. The question that I asked Mr. Serrano and Mr. Chapman is, given this, why did you pay him outside of Korea?

Mr. **Fish**. We initially were paying Mr. Yoon by check mailed to Korea. He complained about the lateness of the checks. This was very early on, according to the record, and those files were furnished to the committee. And he, for convenience, asked that it be placed in the bank account at Dallas, which was where we are located, and it was convenient for us, so we did.

Mr. **Wyden**. What about Korean law?

Mr. **Fish**. Well, I am absolutely unaware, and I don't even know if this testimony that I heard here on my left is right. I am aware of no Korean law. Is anybody else for sure that there is a Korean law that says that you can't deposit the money elsewhere?

Mr. Wyden. Baker & MacKenzie, which is why I raised it with Mr. Serrano, counsel for General Dynamics, analyzed this point and made it clear that this is the law.

Mr. Fish. Well, this is the first that I am aware of it.

Mr. Wyden. Mr. Smith, why did your company make payments outside of Korea?

Mr. Smith. First, our company policy with regard to all consultants is that they can be paid to deposit in a bank in this country or in their country of origin. And I am not aware of any Korean law that would prohibit that.

Mr. Wyden. Mr. Peterson, your position?

Mr. Peterson. I am not aware of any such Korean law. However, our company did pay for the retainer fees to Buyeon in Seoul, Korea. We only paid to a U.S. bank account of Buyeon, payments for prior expenses for which we had receipts. We thought that was the acceptable thing to do.

Mr. Wyden. Mr. Peterson, why did you turn Mr. Yoon down when he wanted the payments in Dallas for the consulting fee?

Mr. Peterson. We simply felt it was more appropriate to pay them in-country.

Mr. Wyden. Why was that? Why was it more appropriate?

Mr. Peterson. I don't personally know.

Mr. Wyden. Was there a legal analysis done?

Mr. Peterson. Not to my knowledge.

Mr. Wyden. There had to be some reason. You said it seemed more appropriate. Wasn't there some justification given for it?

In other words, we want to find out if you were aware of the law, Mr. Peterson, if your company was aware of the law.

Mr. Peterson. No, I say we were not aware of any Korean law that required us to do that.

Mr. Wyden. But it was more appropriate, even though you were not aware of any law, in your view?

Mr. Peterson. Yes, sir.

Mr. Bryant. Would the gentleman yield?

Mr. Wyden. I would be happy to yield to my colleague.

Mr. Bryant. Well. I don't think it's unfair of us to ask you to elaborate on why you thought it was more appropriate. People don't arrive at opinions with no facts or nothing precedent to that. Why did you decide it was more appropriate to pay it in Korea than somewhere else?

Mr. Peterson. Well, it is not unique to Korea. We have consultants elsewhere, and it is our practice to pay in country.

Mr. Bryant. Well, why has that been your practice? Every company policy has a reason. I think it is a good practice. I'm just asking why your company has it.

Mr. Peterson. Well, it certainly doesn't have anything to do with an analysis of the various laws of the various countries because they all differ, I am sure. That is just our practice. We felt that in the case of reimbursement of expenses, that it was appropriate and acceptable to make payments in a bank account in the United States. We have receipts for every one of those expenses. They were previously authorized by us.

Mr. Bryant. I didn't get an answer. I guess it's not worth pursuing. Every company makes decisions based on impressions and understandings and facts. You haven't given us any reason why you made that decision. It seemed like a good decision, seems like you'd have a reason for it. Do you? Do you? No reason?

Mr. PETERSON. None other than what I just stated.

Mr. BRYANT. You didn't state a reason.

Mr. PETERSON. I just stated that it is our practice.

Mr. BRYANT. I asked you why. You didn't tell me why.

Mr. PETERSON. I can't answer that question, sir

Mr. BRYANT. Who can?

Mr. PETERSON. I am sure we can research it and we will provide information to you.

Mr. BRYANT. OK.

Mr. WYDEN. If I might just reclaim my time.

Mr. Peterson, is it typical for your company to pay foreign consultants outside of the countries in which they do business?

Mr. PETERSON. No, sir, it is not typical.

Mr. WYDEN. Excuse me, Mr. Peterson. You paid him in Korea all along, and it was the others that did not. And let me then ask the others whether it is typical to pay foreign consultants outside of the country in which they do business.

Let me ask the other representatives. Mr. Smith?

Mr. SMITH. It is permissible within our international trading operation policies to make payments to banks in this country or into the country in which the consulting agency is incorporated.

Mr. WYDEN. Mr. Fish?

Mr. FISH. It is the same policy.

Mr. CHAPMAN. Our policy is to pay in country or in the U.S.

Mr. WYDEN. Mr. Serrano?

Mr. SERRANO. Congressman Wyden, our policy is to pay by wire transfer or DHL check in country.

Mr. WYDEN. Thank you, Mr. Chairman.

Mr. DINGELL. The gentleman from Texas.

Mr. BRYANT. I just finished.

Mr. DINGELL. The Chair would like to direct these questions to the gentleman, starting from Mr. Peterson.

Were any of the payments to Gen. Yoon charged to the Federal Government, either as part of overhead accounts or as part of requests for progress payments?

Mr. PETERSON. Mr. Chairman, it is our normal practice to charge certain of these types of expenses out of profit, and a certain portion of them to the U.S. Government. We understand that this is an area where there is a great deal of disagreement and a great deal of discussion going on, ever since the new act was passed in 1979.

We believe what we are doing is in accordance with U.S. policy. It is our practice to carry on continuing conversations with the DCAA prior to making any charges that might be disputed in the future and—not that we get prior written approvals, but to get a general understanding of what is acceptable and what is not acceptable.

As I said, we believe what we are doing is in accordance with U.S. policy, the reason being partially that in attempting to make sales overseas, we are trying to put work in our U.S. factories, we are trying to——

Mr. DINGELL. Let me try and get down to the point. I applaud the idea of overseas sales. I strongly favor them. The question is, were the billings to the Government in conformity with law?

Mr. PETERSON. We believe so, sir.

Mr. DINGELL. And my question to you is, were any of the payments that you made, that Martin-Marietta made to General Yoon, charged to the Federal Government, either as a part of overhead account payments, or as part of progress payments?

Mr. PETERSON. A portion of them were, and a portion of them were charged to profit.

Mr. DINGELL. OK. Now, can you tell us, have you submitted to us the information as to which portions were charged to what?

Mr. PETERSON. I believe our package has not been submitted officially, but it will be shortly.

Mr. DINGELL. Mr. Smith, can you address the same question, please?

Mr. SMITH. Yes. As I said in my opening statement, we were asked for this information last week by the committee and we have not made any direct payments to any direct account for the Buyeon expenses, and no charges directly to a specific government account, but we are checking into the fact that there might be some prior charges that were not specifically excluded from overhead accounts used in establishing rates for ongoing spare parts prices, and we are checking into that to see whether there may be an effect on the Government.

Mr. DINGELL. Very well. Mr. Fish.

Mr. FISH. Mr. Chafin asked us Monday afternoon for this information, and it is being collected and will be provided to the committee.

Mr. DINGELL. Thank you. Mr. Chapman.

Mr. CHAPMAN. Mr. Chairman, we have never charged our overhead account.

Mr. DINGELL. You have never charged the payments to Gen. Yoon to the overhead account?

Mr. CHAPMAN. No, sir.

Mr. DINGELL. How about progress payments?

Mr. CHAPMAN. No, sir.

Mr. DINGELL. Mr. Serrano, I believe we have inquired of Mr. Lewis on this point. I guess I have to, in fairness to all the panel members, ask the same question of you.

Mr. SERRANO. Yes. Mr. Chairman, as I indicated to you, we have tagged those foreign selling expenses and as to the specifics for the period March 1979 until we set up our foreign contract pool in January 1984, I think the best thing to do is for General Dynamics to obtain the specifics of what was tagged, but what may have been put in charges to the Government and supply that for the record.

Mr. DINGELL. Without objection, then, the record will remain open for the response from each of our panel members.

[The following information was received:]

RESPONSE FROM RICHARD B. SMITH

(a) A brief explanation of the procedure used to determine overhead is necessary to a clear understanding of the answer.

(b) The overhead percentage to be applied by GE to USG purchases is estimated by GE using a number of factors. One of the factors included at the time of estimating the overhead for 1980–1984 sales was the estimated cost of all consultants, including foreign sales consultants such as Buyeon. This estimated overhead percentage was then negotiated with the USG, and the agreed-upon percentage was then applied to subsequent sales. Therefore, for fixed-price sales during 1980–1984, since estimated total payments to consultants, were included in calculating the overhead percentage, some part of GE's payments to Buyeon during this period has been reimbursed. There was no other reimbursement.

(c) For contracts other than fixed-price sales, there is a historical final dertermination of overhead. At this point in time, actual expense figures are available, and are used to determine the overhead for such contracts. For the years 1980–1984, all amounts paid to Buyeon were eliminated. Therefore, for these contracts, the proposed overhead does not include any reimbursement for payments to Buyeon.

(d) Although final overhead rates for the years 1980 through 1984 have been submitted to the Government, final negotiations have not been completed as of this date.

(e) Starting in 1985, GE's overhead estimates no longer include any projected expenses for Buyeon.

Mr. **Dingell**. Let me go first to Mr. Smith. I gather that General Electric paid Buyeon Co. $2.7 million since 1977; is that correct?

Mr. **Smith**. That's correct.

Mr. **Dingell**. Is it also true that General Electric paid Buyeon in excess of $700,000 for consulting services in 1984?

Mr. **Smith**. I believe the number in our records was $692,000.

Mr. **Dingell**. Now I gather that General Electric agreed to pay Buyeon approximately $800,000 for services in 1985; is that correct?

Mr. **Smith**. I am not familiar with what that number would be. We had an initial 2-year contract, the first 2-year contract we had, but I can't verify that, because there are two contracts; one related to spare parts and one related to the ship marine propulsion operation.

Mr. **Dingell**. Could you submit that for the record, please, Mr. Smith?

Mr. **Smith**. Yes, I can.

[The information follows:]

The Aircraft Engine Business Group of General Electric had agreed to pay Buyeon $600,000 for services in 1985. The Aerospace Group of General Electric had agreed to pay Buyeon $15,000 for services under supporting contracts in 1985. CFM International, the company jointly owned by General Electric and SNECMA of France, had agreed to pay Buyeon $5,000 in 1985. The total figure, even including CFMI, is thus $620,000. The $800,000 is not correct.

Mr. **Dingell**. Mr. Smith, could you tell us why General Electric felt Buyeon's services were worth this sum?

Mr. **Smith**. Buyeon actually were an experienced marine propulsion, marine shipbuilding company, with experts who had background in the shipbuilding business. They gave us considerable technical assistance. They had office people that could help us with the shipbuilding companies, with the Navy, and to help us sell the attributes of our engines. And we did have some stiff competition from Rolls Royce. And as we have heard here earlier, getting access to these people to talk to them, to get into these offices, requires assistance. But they also gave us technical help in the installation, we had engineers working for us, clerical people helping us in the area of processing spare parts sales orders through the direct sales that we made to the Korean Air Force. So they had a complete office operation, and we think that was extremely valuable to us.

As I said earlier, at a lower cost than it would have been if we had been able to do it there with our own people.

Mr. **Dingell**. Could you list the specific projects on which Gen. Yoon had successes on behalf of General Electric?

Mr. **Smith**. Yes. There was a Korean frigate program, to begin with, and then the Korean corvettes, and earlier this year and last year a very active competition related to Korean destroyer escorts.

Mr. **Dingell**. Did Gen. Yoon set up meetings with Korean officers and officials for General Electric?

Mr. **Smith**. Yes.

Mr. **Dingell**. Could you give us the names of those officers and officials?

Mr. **Smith**. I would have to get them. I don't have them.

Mr. **Dingell**. Would you supply them, please?

Mr. **Smith**. Yes.

[The information follows:]

The Korean officers and officials with whom Buyeon set up meetings for General Electric are listed in Attachment I (Navy) and Attachment II (Air Force).

ATTACHMENT 1

KOREAN NAVY CONTACTS ESTABLISHED THROUGH BUYEON COMPANY, LTD.

CHIEF OF NAVAL OPERATIONS

ADM. Hwang
ADM. Kim
ADM. Lee
ADM. Oh
ADM. Choi, S.H.

VICE CHIEF OF NAVAL OPERATIONS

VADM. Yu
VADM. Kim
VADM. Chong
VADM. Ko
VADM. Kim
VADM. Chong
VADM. Chong

DEPUTY CHIEF OF NAVAL OPERATIONS FOR OPERATIONS

RADM. Ko
RADM. Kim
RADM. Chung
RADM. Hwang

DEPUTY CHIEF OF NAVAL OPERATIONS FOR LOGISTICS

RADM. Moon
RADM. Cho
RADM. Kwon
RADM. Lee

DEPUTY CHIEF OF NAVAL OPERATIONS FOR PLANNING

RADM. Kim
RADM. Moon
RADM. Lee
RADM. Choi
RADM. Kim

ASS'T DEPUTY CHIEF OF NAVAL OPERATIONS FOR OPERATIONS

COMO. Kim
COMO. Hwang
COMO. Kim
COMO. Lee
COMO. Cho
COMO. Ku

ASS'T DEPUTY CHIEF OF NAVAL OPERATIONS FOR PLANNING

COMO. Lee
COMO. Yoon
COMO. Choi

DIRECTOR BUREAU OF SHIPS

COMO. Son, J.S.
COMO. Kim
COMO. Kim
COMO. Chae
COMO. Kang

SHIPBUILDING OFFICE

COMO. Om, T.C.
CAPT. Park
CAPT. Kim
CAPT. Chong
CAPT. Kim
CAPT. Ju
CAPT. Kim
CAPT. Ham
CDR. Hur
CDR. Park
CDR. Kim
CDR. Kim
CDR. Bae
LCDR. Kim
LCDR. Lee
LCDR. Park
LCDR. Baik
LT. Kim
LT. Lee
LTJG. Kim

NAVAL LOGISTIC COMMAND

COMO. Lee
COMO. Chong
COMO. Chong
CAPT. Byen
CAPT. Kim
LCDR. Seo
LCDR. Kim

KOREAN NAVY CONTACTS ESTABLISHED THROUGH HUYEON COMPANY, LTD.

(Continued) Page 2

ASS'T DEPUTY CHIEF OF NAVAL OPERATIONS FOR LOGISTICS

COMO. Yoon
COMO. Kim
COMO. Chong
COMO. Lee
COMO. Kim

BUREAU OF SHIPS

CAPT. Jun
CAPT. Lee
CAPT. Chong
CAPT. Kim
CAPT. Choi
CAPT. Chang
CAPT. Kim
CDR. Jun
CDR. Han
CDR. Ro
CDR. Song
CDR. Choi
CDR. Lee
LCDR. Lee
LCDR. Choi
LCDR. Yoon
LT. Yoon
LT. Kim

KOREAN MARITIME POLICE

Commandant Kang
Commandant Hong
Commandant Choi, Y.D.
Commandant Cho

Senior Superintendent Gen. An
Senior Superintendent Gen. Cho

Senior Superintendent Woo, H.G.
Senior Superintendent Lee, S.H.
Senior Superintendent Lee
Senior Superintendent Kim
Senior Superintendent Lee

Superintendent Lee
Superintendent Cho
Superintendent Yim
Superintendent Yu

CAPT. Lee
CAPT. Yu
CAPT. Hyen
CAPT. Kim

NAVAL SHIP YARD

COMO. Cha
COMO. Lee
COMO. Kang
CAPT. Lee
CAPT. Choi
CAPT. Chang
CAPT. Kim
CAPT. Yim
CDR. Tun
CDR. Kim
CDR. Park

HYUNDAI HEAVY INDUSTRIES

Mr. Son, J.S.
Mr. Chae
Mr. Kim, J.S.
Mr. Lee, T.H.
Mr. Do
Mr. Lee, K.I.
Mr. Jun
Mr. Lee, M.K.

DAEWOO

Mr. Hong
Mr. Min
Mr. Ko, C.T.
Mr. Chang, U.D.
Mr. Shin, D.B.
Mr. Kim, J.H.
Mr. Kwon
Mr. Choi
Mr. Chang, S.H.
Mr. Han

KOREAN NAVY CONTACTS ESTABLISHED THROUGH BUYRON COMPANY, LTD.

(Continued) Page 3

KOREA TACOMA MARINE INDUSTRIES

Mr. Lee (President)
Mr. Kim, G.K.
Mr. Park, S.Y.
Mr. Lee
Mr. Ko
Mr. Choi
Mr. Bae
Mr. Ko
Mr. Chong

KOREA SHIPBUILDING & ENGINEERING CO.

Mr. Kim, K.T.
Mr. Cho
Mr. Song, K.S.
Mr. Sin
Mr. Hong
Mr. Namgung, B.

OFFICER OF SUPPLY REPUBLIC OF KOREA

Mr. Nam, D.J.
Mr. So, P.Y.
Mr. Kim
Mr. Kim
Mr. Hong, J.S.
Mr. Kung

DEFENSE PROCUREMENT AGENCY

COL. Kim
COL. Lee
CAPT. Kim
CAPT. Chong
CDR. Park
LCDR Park
LCDR Lee
LCDR Cho
LCDR Choi
Mr. Hong

DEFENSE INDUSTRIES BUREAU

COL. Kim
LCOL. Park, W.B .
LCOL. Chun, T.Y.
LCOL. Lee
CDR. Song
CDR. Lee

ROKAF CONTACTS ESTABLISHED THROUGH BUYEON COMPANY, LTD.

ATTACHMENT II

MEETINGS - SEOUL, KOREA
6/21/78 - 6/29/78

Brig. Gen. Yoo, Ki Won, Deputy Chief of Staff Logistics
Brig. Gen. Lee, K.Y., Vice Deputy Chief of Staff Logistics
Col. Kim, Sung Ho, Defense Procurement Agency, Director Foreign Procurement
Lt. Col. Suh, J.T., Assistant to DPA Director
Lt. Col. Park, T.H., Requirements and Supply Assistant Chief.

MEETINGS FOR KOREAN VISITORS TO U.S.
4/25/81 - 5/2/81

Col. I.B. Kim, Director, Procurement, ROKAF Headquarters
Maj. D.Y. Ahn, Defense Procurement Agency

MEETINGS - SEOUL/TAEGU, KOREA
8/27/81 - 8/29/81

Maj. Gen. Kim, Vice Deputy Chief of Staff Logistics
Col. I.B. Kim, Director Requirements and Procurement
Col. S.K., Oh, Director Material Management
Lt. Col. D.S. Yoo, Chief A/C Eng. Div., DMM

MEETINGS - SEOUL/TAEGU, KOREA
1/31/83 - 2/1/83

Col. Hyung-Kun Kim, Vice Deputy Chief of Staff for Logistics, ROKAF Headquarters.
Col. Dong-Ho Lee, Commander, DMM
Lt. Col. Mun-Kyu Kim, Chief of A/O Eng. Div., DMM

MEETINGS - SEOUL/TAEGU, KOREA
10/21/83 - 10/23/83

Col. Han, Kwang Hee, Asst. Chief of Staff, Studies and Analysis
Lt. Col. Ra, Kum Bok, AF Project Officer
Maj. Kim, Yong Woo, AF Project Officer
Lt. Col. Kim, Mun Kyu, Chief of A/C Eng. Div., DMM
Col. Lee, Dong Ho, DMM Commander

MEETINGS - SEOUL/TAEGU, KOREA
6/5/84 - 6/21/84

Lt. Gen. Suh, ROKAF Vice Chief-of-Staff
Maj. Gen. Han, ROKAF Asst. C/S Studies and Analysis
Brig. Gen. Yoon, ROKAF Vice C/S Logistics
Lt. Col. Park, ROKAF Chief A/C Engine SMD
Col. Kwon, ROKAF Chief Eng. Maint.

OTHER KEY PERSONNEL INTRODUCED THROUGH BUYEON COMPANY, LTD.

Gen. Kim, In-Ki, Chief of Staff
Lt. Gen. Suh, Dong-Yull, Vice Chief of Staff
Maj. Gen. Park, Kun Tee, DSC Logistics
Maj. Gen. Lee, Jae Woo, Commander ALC
Lt. Col. Park, J79/J85 Program Manager, DMM.
Lt. Gen. Suh, Vice Chief of Staff
Maj. Gen. Park, D.C.S. Logistics

Mr. DINGELL. Was there ever any indication that General Yoon had given gratuities or any other compensation for these meetings?

Mr. SMITH. Not at all.

Mr. DINGELL. I find that interesting, because the State Department has indicated that the companies would have known that their payments should underride gratuities in accordance with local custom. The State Department has indicated that the local custom involved gratuities. Is that correct?

Mr. SMITH. I am not aware of the gratuity. Certainly entertainment is a standard practice over there for parties, things like that; but I'm not aware—there may have been small gifts or something like that at a party, but—as there are in Japan and other countries. But I'm not aware of the gratuity aspects of it.

Mr. DINGELL. What was General Electric's policy regarding reimbursing General Yoon for expenses incurred on behalf of General Electric?

Mr. SMITH. I'm sorry, could you repeat that?

Mr. DINGELL. What was General Electric's policy regarding reimbursement of General Yoon for expenses incurred on behalf of General Electric?

Mr. SMITH. With regard to the marine propulsion, there was no reimbursement for expenses. With regard to the spare parts, there was a reimbursement ceiling of something like $25,000 a year, a ceiling.

Mr. DINGELL. Now what is an allowable expense, and what would be an unallowable expense?

Mr. SMITH. An allowable expense would be related to transportation, entertainment, arranging meetings, and things like that.

Mr. DINGELL. Gratuities?

Mr. SMITH. No gratuities; no.

Mr. DINGELL. Now again, this is a repetitive question. Were any gifts or entertainment of Korean officials allowed?

Mr. SMITH. Entertainment was allowed, yes.

Mr. DINGELL. But not gifts.

Mr. SMITH. Not gifts.

Mr. DINGELL. Why did General Electric terminate Buyeon's services?

Mr. SMITH. At the time of the—earlier this spring when attention was drawn to the problems that Buyeon was having, the committee activities, the press, we visited Korea, and we talked to officials in the Government, in the Navy, in the Ministry of Defense, in the shipyards, to determine whether the Buyeon Co. could continue acting effectively for us as a sales representative. And unofficially—they would not give us official statements—unofficially they said that they felt that they just could not deal with them. They could not give us access through them. And therefore, as a sales representative, they could no longer be effective.

Mr. DINGELL. Did you learn anything from the hearings of this subcommittee that General Electric had not already known for some years in connection with either the earlier hearings or your preparation for your appearance today?

Mr. SMITH. I was not aware with regard to anything I've heard, other than what we at General Electric have experienced. I'm not knowledgeable about the other companies.

Mr. DINGELL. Do you have any reason to feel that there are any problems with the way General Yoon has conducted his business over there on behalf of General Electric?

Mr. SMITH. Not at all.

Mr. DINGELL. All right. Let us deal with a couple of other questions.

Did General Electric make payments to Buyeon outside of Korea?

Mr. SMITH. Yes. Checks were deposited in the Dallas bank. And they were also picked up at our offices in New York and one time in Tokyo.

Mr. DINGELL. Why did you do this?

Mr. SMITH. Because they requested it, and it was permissible.

Mr. DINGELL. How much money did General Electric deposit in Dallas for General Yoon?

Mr. SMITH. I believe the number I heard this morning, Mr. Chafin's, was slightly over a million dollars.

Mr. DINGELL. I've heard the figure $1.2 million.

Mr. SMITH. All right.

Mr. DINGELL. Now as with United Technologies, did General Yoon request that General Electric not notify anyone in Korea of those deposits?

Mr. SMITH. We notified Buyeon Co. of the deposits.

Mr. DINGELL. You notified the Korean company. That's Buyeon.

Mr. SMITH. Buyeon Co., yes.

Mr. DINGELL. Did you notify anyone else?

Mr. SMITH. No.

Mr. DINGELL. Were you requested not to notify anybody else?

Mr. SMITH. We were not required to notify anybody else.

Mr. DINGELL. Did you find it peculiar that you were requested to make these deposits outside Korea?

Mr. SMITH. No. It's permissible, and it's done by a lot of different consultants.

Mr. DINGELL. Why did General Yoon want General Electric to make these deposits in places other than Korea?

Mr. SMITH. I don't know.

Mr. DINGELL. Was General Electric surprised that funds deposited in Dallas by General Electric for the benefit of General Yoon never reached Seoul?

Mr. SMITH. I don't know which checks went where. I don't know that they didn't reach Seoul. I have no way of knowing that they didn't reach Seoul.

Mr. DINGELL. Would it be surprising to you if you found that none of these checks deposited in Dallas reached Seoul?

Mr. SMITH. I don't think we considered that we were entitled to know how they ran their business. They may have good business reasons for doing what they did, as a company.

Mr. DINGELL. It's clear that none of the moneys deposited in Dallas reached Seoul.

Mr. SMITH. It appears to be that way from the checks; yes.

Mr. DINGELL. If you had been aware that none of the money that was deposited in Dallas was reaching Seoul, what action would General Electric have taken?

Mr. SMITH. We would not have taken any action.

Mr. **Dingell**. Can you tell me who approved the arrangement whereby the payment was made in Dallas?

Mr. **Smith**. We required through our contracts and our international trading regulations that they notify us in writing on an annualized basis as to where they wanted their checks deposited, the specific locations.

Mr. **Wyden**. I appreciate the Chair yielding.

Why would you have not taken any action at GE, Mr. Smith, if you knew that the money was not going to Seoul?

Mr. **Smith**. Because we didn't require that it go to Seoul.

Mr. **Wyden**. I'm sorry?

Mr. **Smith**. We did not require that it be deposited in Seoul. We did not track the checks or the use of the money, because once it was deposited to their account, it was their money.

Mr. **Wyden**. And you didn't think it was unusual?

Mr. **Smith**. Not at all.

Mr. **Wyden**. Thank you, Mr. Chairman.

Mr. **Dingell**. I'm trying to understand this, the way things worked. General Electric deposits money in a Dallas bank account on behalf of General Yoon.

Mr. **Smith**. On behalf of the Buyeon Co.

Mr. **Dingell**. Buyeon, OK. On behalf of Buyeon. The money then goes to an account in Paris.

Mr. **Smith**. It appears, when looking at the checks, after the committee asked for them, that's what happened to them.

Mr. **Dingell**. Doesn't that strike you as peculiar?

Mr. **Smith**. I'd like to—I think it is a question of why it went to Paris, but I don't know what happened to them.

Mr. **Dingell**. Was any concern ever expressed by General Electric about this matter?

Mr. **Smith**. No.

Mr. **Dingell**. Is there any concern in your mind that General Yoon may have used these funds for violations of the Foreign Corrupt Practices Act?

Mr. **Smith**. Not with respect to General Electric Co.

Mr. **Dingell**. Does General Electric make similar arrangements for deposits with other foreign consultants?

Mr. **Smith**. Yes, we do.

Mr. **Dingell**. Beg pardon?

Mr. **Smith**. Yes, we do.

Mr. **Dingell**. You do.

Could you provide to the committee, for our review, a listing of other relations whereby payments are made outside the country where the consultant does business?

Mr. **Smith**. Yes, we can.

[The information follows:]

GENERAL ELECTRIC COMPANY
(AIRCRAFT ENGINE BUSINESS GROUP & AEROSPACE BUSINESS GROUP)

Foreign Consultants & Sales Representatives Paid Outside Their Own Country

CONSULTANTS & SALES REPRESENTATIVES	COUNTRY	PRODUCT	METHOD & PLACE OF PAYMENT
Allegro (Taiwan) Ltd.	Taiwan	M&I/LM2500	Wire transfer less than $5K to business address in U.S.; over $5K to Taiwan bank (nothing has ever been sent to Taiwan bank).
Cybernetics O.E.	Greece	AEROSPACE/ Armament & Electrical Systems	Payment by check to USA bank.
Forrest Enterprise & Company	Taiwan	Military/ J79/J85/F404	Paid by check to USA bank.
Gold Coin Maritronics Pvt. Ltd.	India	M&I/LM2500	Paid by check mailed to Gold Coin Office in Buffalo, N.Y.
T. Quintella & Associados, Ltd.	Brazil	Commercial/ CF6/CF34 M&I/LM2500 Military/T700 AEROSPACE/Radar Systems & Communication Satellites	40% paid by check to USA bank. 60% paid by wire transfer to Brazil bank.
Souki, S.	Middle East	AEBG Products AEROSPACE	Paid by check to USA bank

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Mr. Dingell. Are you aware that in addition to the deposits in the Dallas bank accounts, that General Electric checks were deposited into a Paris bank account?

Mr. Smith. We were aware of it when we saw the checks that we submitted to you.

Mr. Dingell. In fact, according to the review of the committee, the Chair observes that some 20 checks, totaling approximately $360,000, were deposited in Paris.

Did you have an awareness of that?

Mr. Smith. Not until the committee asked us to submit the checks.

Mr. Dingell. What would General Electric have done, had you been aware of the practice of deposits moving from Dallas to Paris or directly to Paris?

Mr. Smith. We would not have done anything.

Mr. Dingell. You would not have done anything.

Thank you very much.

The gentleman from Oregon.

Mr. Wyden. Mr. Serrano, we are interested in a memo that you wrote on April, of 1985 that went to many people, including Ms. Carver. In the memo, you say, "As to Mr. Durr's conduct and behavior"—excuse me; it's based on a phone call with General Yoon, and you say:

> As to Mr. Durr's conduct and behavior in Korea the last twelve years, his conduct is judged not clear. Some bad stories have been reported. The relationship with Mr. Asbury and General Park is very bad. Last June, when Mr. Sawyer saw General Park and General Roo, according to Mr. Go and Mr. Durr, what Mr. Asbury did was to blame Buyeon. General Park was arrested. They say he was bribed by G.D. Why did he sign the MOU with the United States Government? There is more in it for G.D. that way.

Then you go on to say, "They believe there was corruption involving General Park."

What is all of this about? It is very hard to figure this out in my view, but it is based on a conversation that you had with Mr. Yoon. You talked at 10:30 at night several days before.

Mr. Serrano. Yes, Congressman Wyden. I think that memo is in this package—yes, here it is.

This is essentially what General Yoon said when he called that Saturday evening, and perhaps—there are so many items in here that perhaps it would be your preference to ask about the specific things.

Mr. Wyden. Well, that's a good idea. What about the conduct and behavior in Korea the last 12 years of Mr. Durr?

Mr. Serrano. My reaction is that that is completely out of line. You know, Yoon had an intense dislike of Mr. Asbury, because he judged that Mr. Asbury tried to diminish his role as a representative for G.D. In fact, Mr. Asbury happened to be the manager who opened the new office, who moved our office from General Yoon's office to the new G.D. location.

So these comments about Asbury and Mr. Durr——

Mr. Wyden. Well, excuse me. Why, then, did Mr. Asbury have to be pulled out of Korea and sent somewhere else? I understand he was sent to Belgium.

Mr. **Serrano**. Yes. He had been in Korea for 3-plus years, and it's a very difficult country. He wanted to remain in International, and he had clashes with General Yoon. As I mentioned to you, this March, all of those clashes over role came to a head. We were not going to allow Yoon to be our marketeer.

Mr. **Wyden**. Well, why was Mr. Park arrested, which is discussed—General Park?

Mr. **Serrano**. OK. The General Park situation—and this is all a matter of public record. There was a very serious set of negotiations going on early this year between the United States Government and the Government of Korea. There is a program for them to build an indigenous tank. Some of the Koreans disputed the ownership of the technology, which was M-1, M-60 technology developed by funds provided by the United States taxpayer. General Park happened to be the individual, as I recall, who came to the United States and signed the agreement with the United States Government; signed for the Government of Korea to the United States Government agreement that said, "This technology is the property of the United States taxpayer and does not revert to the unencumbered use by the Korean Government."

Precisely because he was the individual that signed, which was a very unpopular move—he happened to be the man on the watch—that when he returned to Korea, it is conjectured that he was removed from his job.

It was a very sensitive series of negotiations, Government to Government, and General Yoon is trying to say that Mr. Asbury said, "Well, Buyeon is no good," because Buyeon Co. wanted to work on that tank project. They wanted to be G.D. representatives. We said no.

Mr. **Wyden**. But this all involves G.D. programs, Mr. Serrano, and, you know, it's my understanding that General Park was arrested because he signed this MOU that has more in it for General Dynamics, and people over there thought he was bribed.

Mr. **Serrano**. In fact, Congressman Wyden, if the United States Government took the position that the technology was Korean technology, then there would be more sales dollars in it for General Dynamics, because, as we understand the situation, the intention was that the Koreans wanted to acquire and own our M-1 technology and use it for third-country sales. And rightly so, the Members of Congress and the United States Government said, "Absolutely not. It is the law of the land that that technology, funded by the U.S. taxpayer, belongs to us."

And he signed that MOU. He agreed to that. And he was not popular, because of that, to the Government of Korea. What their judgment was, I don't know. But I do believe that he was removed from his job.

Mr. **Wyden**. What about any specifics about Mr. Durr's conduct and behavior in Korea?

Mr. **Serrano**. We have no evidence of wrongdoing whatsoever regarding Mr. Durr—Mr. Durr is one of our longest-term employees. Mr. Durr has spent virtually the last 17 years overseas.

Mr. **Wyden**. Did Mr. Yoon raise any specifics about Mr. Durr?

Mr. **Serrano**. No, sir. We have confidence in Mr. Durr.

Mr. **WYDEN**. But clearly, some bad stories were raised. It says that in your memo.

Mr. **SERRANO**. I'm just reproducing, without trying to color any of these words, for the addressees what General Yoon said to me on the telephone, sir.

Mr. **WYDEN**. Well, that certainly sounds like some bad stories to me.

Mr. **SERRANO**. There are enough people in General Dynamics who have regular contact with Mr. Durr, and Mr. Durr has been given a number of positions of responsibility. It's sour grapes on the part of General Yoon, sir.

Mr. **WYDEN**. Thank you, Mr. Chairman.

Mr. **DINGELL**. The Chair thanks the gentleman.

The gentleman from Texas.

Mr. **BRYANT**. Mr. Serrano, we have a letter here dated March 14 that was written by Mr. Gurr—Durr—I'm sorry, Gurr—to G.A. Sawyer with copies to a bunch of other people as well, in which he explains the outright impossibility of being able to contact anybody over there that you wanted to make sales to in the South Korean Government without the help of the Buyeon Co. He talks at one time about talking to Mr. Park about setting up the meeting for the Fort Worth team. Mr. Park said, "I must use the Buyeon Co. to set up the meeting."

Another time, it says they met with Major Kim and explained that they wanted to meet with his people. He said in very plain English to General Dynamics that "General Dynamics must use our consultant to set up meetings with those people, because security will not allow direct contact between them and the contractor" and so forth.

Again, you explained to Mr. Kim, I think, your man explained to him that you temporarily didn't have any relationship with Mr. Yoon, and Mr. Kim told you, in effect, "Too bad. It can't be done directly. You must use your consultant to be legal here" and so forth like that.

What is it about South Korea that you can't do any business over there except by using Mr. Yoon?

Mr. **SERRANO**. That's not correct. This particular memo, written in a great deal of frustration by Mr. Gurr, as he says at the end in italics, "This is very bad for my rotten disposition."

Mr. **BRYANT**. Well, is his memo correct? I mean, wasn't it true that you couldn't get in to see anybody without using Mr. Yoon?

Mr. **SERRANO**. In point of fact, this was a marketing visit by our Fort Worth marketing team for which he was trying to set up these meetings. Step One, Mr. Gurr—and they had agreed that this would be the procedure—Mr. Gurr would call General Yoon and say, "Please get us a meeting set up," and the first thing that happened was, General Yoon said, "Put it in writing."

And if you can imagine, these fellows are a few blocks apart. So our man-in-country makes a written request, and General Yoon——

Mr. **BRYANT**. Just a minute there. You're kind of going very far afield.

Mr. **SERRANO**. Your question was, is it possible to get meetings without this consultant? The answer is yes.

Mr. **Bryant**. I'm saying, why, if it's yes, then why did Mr. Gurr write a long letter to Mr. Sawyer and others, saying, "Look, I've been told repeatedly, I've got to have Mr. Yoon in order to get in to see these people." Mr. Park told him that; Mr. Kim told him that. He goes on at length. This is a four-page letter.

Mr. **Serrano**. Yes.

Mr. **Bryant**. Detailing the fact that he can't get in to see people without Mr. Yoon.

Mr. **Serrano**. And yet that very week, the guy from Fort Worth picked up the telephone and called the Protocol Officer and got in to see the very fellow that Yoon said we could not get to see. In fact, we found out that Yoon had——

Mr. **Bryant**. Just a minute. Just a minute. Mr. Yoon didn't say you couldn't see these people. Let's keep our story and our facts in line here.

This is a letter from your guy in Korea, Mr. Gurr, to Mr. Sawyer, former Navy employee, now at General Dynamics, we have talked about in almost every hearing.

Mr. **Serrano**. My boss.

Mr. **Bryant**. Your boss, executive vice president of the company; is that his job?

Mr. **Serrano**. Yes, sir.

Mr. **Bryant**. Explaining—this is almost to the top guy in the company, almost all the way to the top—explaining that we can't get in to see anybody over there in South Korea unless we have Mr. Yoon, and he talked to Mr. Park, and he says specifically I must use the Buyeon Co. to explain to Mr. Park that, well, we don't have a relationship with Mr. Yoon right now, and he still said too bad, you've got to have Mr. Yoon. They talked to Mr. Kim, who speaks English, apparently, and he told them in plain English that's what the letter says, he told us plainly in English we could not do that without Mr. Yoon.

What is the relationship between Mr. Yoon and those guys in South Korea that nobody can get in to see them except through him?

Mr. **Serrano**. The fact is, you can get to see people on a direct basis, and the fact is that it was in General Yoon's interest to try to make us feel that he was the only gate to be able to meet the Air Force officials, and that is not true, and we had a big fight over it.

Mr. **Wyden**. Would the gentleman yield?

Mr. **Bryant**. Just a minute.

You are being quite dishonest in your response to my questions, by attempting to answer questions I haven't asked. I don't care what Mr. Yoon told you for the time being. What I am asking you is why does the situation exist as reported by your man in Korea to the executive vice president of your corporation that nobody can get in to see these military hot-shots in South Korea unless Yoon is there alongside them? Now why did he say that to your company? What is the situation that makes that the case?

Mr. **Serrano**. Your question is what is the situation that makes that the case, and my response to that is this is an overstatement on the part of Mr. Gurr, who is very frustrated, and the fact is we can get to see officials without General Yoon, and we had a big fight over it, and it was one of the major reasons that we decided to let General Yoon go. You don't need a consultant—you need a consultant to help you with protocol, but you don't——

Mr. BRYANT. Just a minute. This letter is from your man in South Korea, not from Mr. Yoon, this is from your American employee, a General Dynamics employee in South Korea, that says you do have to have Mr. Yoon to get in to see people. Now who knows more about South Korea and the relationship between General Dynamics and the Government than Mr. Gurr?

Mr. SERRANO. Mr. Gurr is a relatively new guy in Korea, never been overseas on an assignment for our corporation, and in my judgment is overreacting here because, in fact, they got a meeting with the Air Force people, sir.

Mr. WYDEN [presiding]. Would the gentleman yield.

Mr. BRYANT. Yes.

Mr. WYDEN. I appreciate your yielding, because it seems that sometimes the company says they need Mr. Yoon, and sometimes it seems the company says they don't need Mr. Yoon. I would like to know what exactly does Mr. Yoon do for you, or did for you? What exactly did he do?

Mr. SERRANO. All right. No. 1, we didn't have an office for 7 years, and we used his office. We used all of his secretarial help, telex facilities.

Secondly, there were projects for Stromberg-Carlson similar to the kinds of——

Mr. BRYANT. Well, that's not—Mr. Chairman—would you indulge us by not running back through all of your prior testimony today? The question is very simply put:

Do you need Mr. Yoon there or not?

Mr. SERRANO. We need an interpreter, we need a translator, we need somebody to rent some cars to get us over to a meeting at the Air Force headquarters. We need someone to sit in a meeting and translate and make sure that——

Mr. BRYANT. Well, apparently, according to your man in South Korea, you need Mr. Yoon in order to get in to see the South Korean Government. Now you find it convenient to say today that Mr. Gurr is inexperienced and all that business.

By the way, where is Mr. Gurr today?

Mr. SERRANO. He is in Korea.

Mr. BRYANT. In the same job?

Mr. SERRANO. Yes.

Mr. BRYANT. Well, has he been demoted or——

Mr. SERRANO. No, sir.

Mr. BRYANT. Has his pay been docked for sending such an erroneous memorandum to you guys?

Mr. SERRANO. Well, he ceases to have the kinds of difficulties with Gen. Yoon that he indicates in the letter, because Gen. Yoon isn't there——

Mr. BRYANT. Just a minute. He didn't—once again, you are being dishonest, Mr. Serrano. From time to time you're a dishonest person here today. You keep saying—you said just then he says he doesn't have these problems with Mr. Yoon any more. I didn't say he had problems with Mr. Yoon, did I? Did I? Does this letter say he had problems with Mr. Yoon?

[The witness reviewing the letter.]

Mr. **Wyden**. Would the gentleman yield?

Mr. **Bryant**. I can hardly contain my exasperation and disgust with Mr. Serrano's method of trying to deceive this committee. The letter that I made reference to is a letter explaining to Mr. Sawyer of your company that he can't get in to see people unless Mr Yoon is alongside of him.

Don't answer me by saying he has no complaints any longer with Mr. Yoon. That is an irrelevancy and that's a very clever deception. I suppose you run your company that way, but we don't accept that here.

My question to you is this:

Is Mr. Gurr still the South Korean man for General Dynamics?

Mr. **Serrano**. Yes, he is, Congressman Bryant.

Mr. **Bryant**. Well, then, how does that square with your previous statement that Mr. Gurr is inexperienced, had never been there before, and was tired and worn out, and so forth and so on, and therefore wrote an erroneous memorandum?

Mr. **Serrano**. Let me reference page 5 in the second paragraph.

Mr. **Bryant**. Just answer my question.

Mr. **Serrano**. I think this is the key and the crux of this whole memorandum and, in fact, it summarizes the clash that led to our decision not to work with Gen. Yoon any further.

Mr. **Bryant**. I am not interested in what led to your decision not to work with Mr. Yoon any more. I'm asking you why it is that you can deny today that you had to have Mr. Yoon to get in to see the South Korean Government when you have a memorandum right here from your top guy, who is today your top guy in South Korea, that says you had to have him.

Mr. **Serrano**. Well, clearly that is not correct. You can see Korean officials——

Mr. **Bryant**. I see. OK.

Mr. **Wyden**. Would the gentleman yield?

Mr. **Bryant**. I'd just like to ask one last question.

What is it, in your opinion, Mr. Serrano, that Mr. Yoon was doing for the South Korean officials, like Mr. Park and Mr. Kim, that they would refuse even one time, and make such categorical statements even one time to your man, who is still your man in South Korea, that they wouldn't talk to General Dynamics directly, that you had to have Mr. Yoon?

Mr. **Serrano**. Let's not forget that——

Mr. **Bryant**. Well, answer my question. What is it that he was doing for Mr. Park and Mr. Kim to command that kind of loyalty from the South Korean Government?

Mr. **Serrano**. First of all, I don't think my opinion is really the issue here, and I don't know; OK? I just don't know.

Mr. **Bryant**. What does Mr. Gurr say the reason—what does Mr. Gurr say he has been doing for them to command that kind of loyalty?

Mr. **Serrano**. Mr. Gurr doesn't say anything, but Gen. Yoon's record says he was the first superintendent of the Air Force Academy in Korea, and a lot of the younger fellows that are coming along in their careers probably looked up to him as the national hero that he was. Perhaps that generates loyalty. I know it does in our own Air Force.

Mr. **Bryant**. How long ago was that?

Mr. **Serrano**. Quite some time ago.

Mr. **Bryant**. Well, how long ago was it?

Mr. **Serrano**. I know that he left the Air Force probably the time he was starting at KTMI, 1974.

Mr. **Bryant**. How long ago was that?

Mr. **Serrano**. That was probably 1974, 10 years ago.

Mr. **Bryant**. About 10 or 11 years ago. This letter was written about 4 or 5 months ago that I'm talking about right here.

Mr. **Serrano**. Congressman, I respectfully say that it is possible to meet with Korean officials on a direct basis. You must know the protocol and respect the protocol

Mr. **Bryant**. Well, apparently the guy that your company chose to send to South Korea to be its chief guy in South Korea disagrees with you, based upon the written letter that I presented to you this morning.

Mr. Chapman, do you have anybody in South Korea or have you had anybody over there all this time besides Mr. Yoon?

Mr. **Chapman**. As a permanent officer? No.

Mr. **Bryant**. You've just had Mr. Yoon all this time?

Mr. **Chapman**. Yes, sir. Buyeon Co. is a consultant.

Mr. **Bryant**. Mr. Fish, how about you? Have you had anybody besides Mr. Yoon?

Mr. **Fish**. In the mid 1970's, mid to late 1970's, the record shows that we had one American individual over there for an extended period, but it was never viewed as a permanent assignment, and he was brought back.

Mr. **Bryant**. Mr. Yoon was——

Mr. **Fish**. Yes, essentially Mr. Yoon was our——

Mr. **Bryant**. He was the only Korean person?

Mr. **Fish**. He was our consultant there.

Mr. **Bryant**. Mr. Smith?

Mr. **Smith**. We have a General Electric office serving the overall General Electric nonaircraft activities there, which is not related to what we do with the Navy or the Air Force. We currently have one young man over there on a year's assignment.

Mr. **Bryant**. But I am saying during the period of time under discussion for the last 10 years, have you had anyone other than Mr. Yoon—I think your term was "interfacing," for you with the South Korean military?

Mr. **Smith**. No. Well, I want to correct that statement. We do have another consultant dealing on our engine program for the F-16.

Mr. **Bryant**. How long has he worked for you?

Mr. **Smith**. Since last November.

Mr. **Bryant**. OK. That's when it was clear you had a conflict of interest, or that Mr. Yoon would have a conflict of interest between General Dynamics and you?

Mr. **Smith**. We just didn't consider him as a logical consultant in that respect.

Mr. **Bryant**. And Mr. Peterson?

Mr. **Peterson**. No, during that time we had no Martin-Marietta employee living or working in Korea. We only had Buyeon as a consultant.

Mr. **Bryant**. Well, I think the point is we have got the defense establishment sitting in front of us, and the man to see in South Korea was clearly Mr. Yoon. If anyone has any evidence or comments that would refute that, I'd be glad to hear it. It seems to me to be an inevitable conclusion.

Mr. **Wyden**. If the gentleman would yield.

One other point. Mr. Serrano—I mean, I have gotten two facts out of this:

You needed Mr. Yoon so much you got rid of him, No. 1; and No. 2, you paid a national hero $250,000 to rent some cars and do some translations. That's what I have gotten out of this. And the only plausible explanation I get when I look at those two facts—and I have been here virtually the whole time—is that under that kind of an arrangement, the money certainly could have been used for some very questionable activities. What is wrong with my analysis? Is there anything?

Mr. **Serrano**. If you have a specific question, or if you are asking me——

Mr. **Wyden**. The two facts—you needed him so much you got rid of him, and you paid a national hero $250,000 to do a few translations and rent some cars. And it looks to me like this was really an instrument for engaging in some activities that are either violations of the law or certainly improper.

Mr. **Serrano**. Congressman Wyden, we feel that we got very good value for the dollars that we paid to General Yoon. He was a superb technical adviser. He provided logistic support, simultaneously, at times, for a radar project, for a telecommunications project, for interface with the Korean Air Force.

We asked if he could work with the Korean Army on the tank program, and it was the Army that said—not because he was a bad guy, but they said he is an Air Force guy, no, we don't want him to work that project.

But in the records that we provided to you, as I said, you will see over 36 reports, close to 300 pages by a fellow who did very professional marketing analysis and assessment for us. The guy did a substantial job for us, short of having our own people there.

And then, of course, we did add our own people. But in the process, what you see in this letter with Gurr—we have had four representatives in country, and we reached the point where we didn't want to see Yoon "chew up" yet another GD permanent employee. But the man did a substantive job as a marketing consultant for us, sir.

Mr. **Wyden**. I want to turn now to LTV and to you, Mr. Fish. Hasn't LTV paid General Yoon more than $400,000 since 1973?

Mr. **Fish**. Yes, I believe that is the figure that we provided.

Mr. **Wyden**. Can you explain why LTV was paying Gen. Yoon 3 years prior to him forming Buyeon?

Mr. **Fish**. He was hired as a consultant, and I emphasize I joined the company in 1979, so I am restricted to be able to testify as to the records, and the records I was able to have surveyed indicate that he was hired back then as a consultant because he was knowledgeable in the area that the company wanted to pursue markets.

Mr. WYDEN. By the way, I think I should have asked something right at the outset.

Would the gentleman from Minnesota like me to yield to him?

Mr. SIKORSKI. If the gentleman would yield.

Earlier in this investigation by the subcommittee, we came across instances which are colloquially referred to as revolving door. The chairman of the subcommittee asked the chairman of the full Committee on Post Office and Civil Service to undertake an investigation into these matters, which is being undertaken in my Subcommittee on Investigations of Post Office and Civil Service.

Mr. Fish, I understand you are a retired Air Force lieutenant general; is that correct?

Mr. FISH. That is correct.

Mr. SIKORSKI. And in the Pentagon you had some involvement in the foreign sales, is that correct?

Mr. FISH. That is correct.

Mr. SIKORSKI. Could you highlight for us what your jobs were and what your responsibilities were up until what point?

Mr. FISH. That was 37 years. Where do you want me to start?

Mr. SIKORSKI. Well, probably at the end. You went to LTV when?

Mr. FISH. In 1979.

Mr. SIKORSKI. And that was at the end of 37 years?

Mr. FISH. 36 years, 10 months and 9 days.

Mr. SIKORSKI. Close enough. And when you retired from the Air Force, you retired at what level?

Mr. FISH. Lieutenant general.

Mr. SIKORSKI. And you were then doing what in the Pentagon?

Mr. FISH. I was Assistant Vice Chief of Staff for the Air Force.

Mr. SIKORSKI. And what were your responsibilities as such?

Mr. FISH. Well, essentially to assist the Chief and the Vice Chief in the running of the Air Force, particularly the Air Staff.

Mr. SIKORSKI. What was your involvement in foreign sales in that position?

Mr. FISH. I had none. Very peripherally.

Mr. SIKORSKI. OK. That was 1979, did you say?

Mr. FISH. 1979 is when I left.

Mr. SIKORSKI. Before that, what was your position?

Mr. FISH. I was the Director of the Defense Security Assistance Agency and the Deputy Assistant Secretary, Defense for Security Assistance.

Mr. SIKORSKI. And that involved in foreign sales?

Mr. FISH. Yes, that was involved in foreign sales.

Mr. SIKORSKI. In fact, that is the organization within the Pentagon that would be the primary center——

Mr. FISH. It administers the foreign sales program.

Mr. SIKORSKI. So the F-16, for example, which we talked at length about earlier in the hearing, was in the contract that Mr. Serrano talked about, a government-to-government contract? Would that be in fact coordinated through your office?

Mr. FISH. Yes, except that it occurred after I left. It would have been, yes, that's right.

Mr. SIKORSKI. According to Mr. Serrano, it occurred before you left.

Mr. FISH. Well, that is a matter of exactitude whether you want to talk the LOA.

Mr. SIKORSKI. And now you are involved in international sales with LTV?

Mr. FISH. I am vice president international for the LTV aerospace and defense.

Mr. SIKORSKI. And you started with LTV at what position?

Mr. FISH. That position. It's the same position I went with them in.

Mr. SIKORSKI. When did you stop doing the assistant secretary defense stuff with Securities——

Mr. FISH. Early 1978.

Mr. SIKORSKI. So about a year and a half? Early 1978 you stopped doing that, and then when did you go to LTV?

Mr. FISH. In the summer of 1979.

Mr. SIKORSKI. So about 15 months later?

Mr. FISH. Approximately.

Mr. SIKORSKI. Do you have interaction with the people that you worked with in the Pentagon then?

Mr. FISH. At times, but primarily my work is offshore working with foreign governments. Occasionally I am called in by DSAA and others because of the knowledge I have and am asked for views.

Mr. SIKORSKI. What do you know about Yoon and others like him from the Pentagon perspective?

Mr. FISH. I had never heard of Mr. Yoon until I went with LTV, so I have no knowledge of him independent of my work with LTV.

Mr. SIKORSKI. How about these foreign consultants?

Mr. FISH. What about them?

Mr. SIKORSKI. What was your Pentagon perspective of foreign consultants?

Mr. FISH. That most of the companies used them, some of them were good and some of them were not so good. Sometimes they were needed, sometimes they are rainmakers. It's a very mixed bag.

Mr. SIKORSKI. I thank the Chairman very much, and I thank you, Mr. Fish.

Mr. WYDEN. Mr. Fish, we have established that LTV paid General Yoon over $400,000 since 1973. You said LTV was paying General Yoon 3 years before he started his company in a consulting kind of relationship. During that time, wasn't General Yoon President of Korea Tacoma Marine Industries?

Mr. FISH. I have no independent knowledge of that, but I notice that that is what Mr. Chafin testified to and I'm sure it's correct.

Mr. WYDEN. Did LTV ever conduct business with Korea Tacoma Marine Industries?

Mr. FISH. Not that I'm aware of.

Mr. WYDEN. Is Korea Tacoma Marine Industries privately owned?

Mr. FISH. I don't know, Mr. Wyden. I have no knowledge of Tacoma Marine Industries.

Mr. **Wyden**. What was General Yoon doing for you at the time he was President of Korea Tacoma Marine Industries?

Mr. **Fish**. As I stated, the available records, which we have provided to the committee, which go back to 1973, indicate that he was hired on a letter contract to be a consultant on the then Vought programs.

Mr. **Wyden**. Were Korean officials aware of your relationship with General Yoon from 1973 to 1976?

Mr. **Fish**. Again, I would have difficulty answering that of my own knowledge, but I don't mind giving you an opinion. The opinion is yes, that they would know of him.

Mr. **Wyden**. What projects did Buyeon work on for LTV from 1976 to 1983?

Mr. **Fish**. Primarily the sale of A-7 aircraft, earlier on the Lance missile system, and then later on the multiple launch rocket system.

Mr. **Wyden**. Why did the company terminate its relationship with Yoon and Buyeon?

Mr. **Fish**. It was my judgment that he wasn't being effective in furthering our programs and that it was better to reduce the cost.

Mr. **Wyden**. Did General Yoon set up meetings with Korean officials for LTV?

Mr. **Fish**. Yes.

Mr. **Wyden**. Can you give us the name of those officials?

Mr. **Fish**. Well, there were probably a fairly goodly number. Some of them jump to mind. I can do it more by title. Like from the chief of their general staff, chief of their Air Force, their operational requirements people. That is generally it.

Mr. **Wyden**. We will leave the record open, and if you would like to submit additionaly information on that point, that will be fine.

[The following information was received:]

Organization	Name of Official
Land Weapon Systems	(Cheif) Colonel Jo, Dong-Ho
P & D Bureau DCSOPS, ROKA	Colonel Uh, Chief, Artillery Section,
Daewoo Heavy Industries	Young S. Yoon, President
International Sales Department, Daewoo	Young-Chul Park
Special Project Division Daewoo	Y-H Yang, General Manager
Dong In Company	Dong Sik Lee, President
Weapon Systems Secretary	Major Jang
ROKAF Headquarters	General Ok, General Joo, General Kim
Blue House	Mr. Oh
Economic Planning Board	Mr. Kang, Director of Industrial Promotion Bureau
Economic Planning Board	Mr. Pak, Division Chief
Economic Planning Board	Mr. Pack, Departmental Chief
Ministery of Transportation	Mr. Kim, Director of Civil Aviation Bureau
Ministery of Transportation	Mr. Kwon, Chief of Aviation Operation Division
Ministery of Commerce and Industry	Mr. Wan, Director of Heavy Industry Bureau
Ministry of Science and Technology	Dr. Kim, Councilor
Ministry of National Defense	Major General Shin, Director of Defense Industry Bureau
Ministry of National Defense	Colonel Song, Chief of R & D Division and Member of DAPRC
Korean Air Line Corp.	Mr. Cho, Vice President
Korean Air Line Corp.	Mr. Lee, Vice President, Engineering Department
ROKAF Headquarters	General Ock, Chief of Staff

Mr. **Wyden**. Did LTV have any indication that General Yoon may have engaged in improper activities to win contracts?

Mr. **Fish**. None. We had no such indication.

Mr. **Wyden**. Did General Yoon or any other Buyeon official give gratuities or any other compensation to Korean officials in connection with activities for LTV?

Mr. **Fish**. None that I am aware of. I want to qualify only that there were periods when there is a traditional gift-giving time out there where minor gifts, not of great value, are given.

Mr. **Wyden**. How do you respond to the Embassy claim that gratuities are part of the way that business is done in Korea?

Mr. **Fish**. Oh, that's very true. As Mr. Smith pointed out, it is probably true throughout the Far East, in Japan and other parts of the Far East. But there again——

Mr. **Wyden**. I'm sorry. Excuse me. I think Mr. Smith said that he didn't know anything about gratuities. That was the impression that I got.

Mr. **Smith**. The comment I made was that at parties and dinners, it is customary to have a small gift, but nothing of great significance.

Mr. **Fish**. And that is my testimony, too. I am just seconding him.

Mr. **Wyden**. What is a small gift? I'm curious.

Mr. **Fish**. Oh, let's see if I can think of something. You might give a pen and pencil set.

Mr. **Wyden**. Thank you.

The gentleman from—I believe it's the gentleman from Minnesota's time next.

Mr. **Sikorski**. Mr. Serrano, I guess I have two things. Earlier today we talked about this letter to Mr. Veliotis from Buyeon, May 26, 1982. In it there is a comment by Mr. Yoon that, "During these contract negotiations, I have had to support the sale in the past and the many obligations I will be expected to respond to in the future. At this moment, everyone is aware that I have no contract and it has left me alone. However, should I sign the proposed contract, they will be bothering me."

That is somewhat curious.

Mr. **Serrano**. Your question is what does it mean?

Mr. **Sikorski**. Yes. What do you think it means?

Mr. **Serrano**. Well, that is a matter of opinion. My own personal opinion that I would relate to the comments about gratuities is Korea is—the folks you work with in Korea are like a work family, and they figure that Yoon did well and they say, well, gee, the guy has got to make contributions to military organizations and the like, to be hit up for charitable contributions. That would be an expectation.

In fact, he felt so strongly about it, I think, that in the same meeting, he asked Veliotis to please find him a way to go to Harvard, that kind of thing. Veliotis said, yeah, we will do that.

Mr. **Sikorski**. But no, no, no. I appreciate that, and that is discussed, if not in this, in the surrounding documents, but, "At this moment everyone is aware that I have no contract with General Dynamics and has left me alone. However, should I sign the proposed contract, they will be bothering me." It seems to me if your interpretation were accurate, he would have stated specifically that all these nonprofitable and charitable organizations will be after him. You know, is this a United Way offering?

Mr. **Serrano**. It could be. I don't know what specifically he is referring to. Those are the words he said.

Mr. **Sikorski**. But the point is, it is right there in the principal paragraph of this contractual—this letter, in the midst of these contractual negotiations for a new contract. And if it were that kind of thing, it seemingly would be incidental, or a very minor part of your contract negotiations.

Mr. **Serrano**. I just don't know. We got into negotiations with him. They were interminable. But I just don't know. And it was the 90-day notice thing that he highlighted: here I have worked for you for so many years, and now you are going to have a clause where you can throw me out the door.

Mr. **Sikorski**. Well, he talks about this elsewhere, in phone calls and memos. He talks about the same thing, how these people are going to bother him or are bothering him and have bothered him, and he has had financial responsbilities with regard to these things. Isn't it the admirals and generals that are bothering him?

Mr. **Serrano**. No.

Mr. **Sikorski**. It isn't—you don't know what it is, but you tell me it isn't admirals and generals?

Mr. **Serrano**. I was saying I just don't know.

Mr. **Sikorski**. I know it is comfortable to assume that it is nonprofit charitable organizations, but I can't believe that it rises to the point where it would be a principal part of this offer on a contract. But you know for sure that it wouldn't be admirals and generals?

Mr. **Serrano**. No. That was a reaction kind of thing, thinking about who he could really get meetings with: Colonels and technical kinds of people. About the highest level that I am aware of was the Chief of Staff of the Air Force.

Mr. **Sikorski**. So he was paying for meetings with these people?

Mr. **Serrano**. No, sir.

Mr. **Sikorski**. Well, we are talking about money here; we are not talking about meetings, we are talking about money. He has to have money because these people bother him as soon as they find out he has got a contract with——

Mr. **Serrano**. I just don't know who General Yoon is referring to.

Mr. **Sikorski**. Well, it sure should raise a question with someone with regard to the Foreign Corrupt Practices Act. My question, then, for you and everyone is, When these dollars end up in Paris, where do you think the money went?

Mr. **Serrano**. He could be giving to charity.

Mr. **Sikorski**. Mr. Chapman, do you believe the United Way explanation?

Mr. **Chapman**. Sir, I don't know where it would go.

Mr. **Sikorski**. Are there some special charities in Paris, Mr. Fish?

Mr. **Fish**. I am unaware of any.

Mr. **Sikorski**. All you guys had money that ended up there—over $3 million, $3.25 million. You guys did, United Technologies? Are you shaking your head "no"?

Mr. **Fish**. I am unaware of any of our money ending up anywhere except in the banks that we sent it to.

Mr. **Sikorski**. You paid him in Dallas.

Mr. **Fish**. That's right.

Mr. **Sikorski**. Well, there were $440,000 deposited in Paris via Korea. You must have paid him in Korea and then he took that check—oh, I'm sorry. United Technologies.

Mr. Smith.

Mr. **Smith**. I don't know. I don't have any idea.

Mr. **Sikorski**. How about you, Mr. Peterson?

Mr. **Peterson**. Negotiated in Paris was around $10,000 for two small expense checks.

Mr. **Sikorski**. All fees were sent to Korea and deposited in Korea, $230,000. Most expenses to Dallas, two to Paris for $80,000. Is there a business reason for this money to be in Paris?

Mr. **Peterson**. No. I said we found that two small checks that we had sent to reimburse him for expenses, around 10,000 dollars' worth——

Mr. **Sikorski**. All right. This is for all of you. You have got American corporations with international sales. You hire a foreign consultant to help you in Korea. He is a Korean national on a business visa to the United States. Is there a business reason that you can fathom why Buyeon or Mr. Yoon has your moneys going to Paris? A legitimate business reason.

Mr. **Peterson**. I don't know.

Mr. **Sikorski**. Mr. Smith?

Mr. **Smith**. I don't know.

Mr. **Sikorski**. Mr. Fish? Oh, you don't end up. Mr. Chapman?

Mr. **Chapman**. No, sir.

Mr. **Sikorski**. Mr. Serrano.

Mr. **Serrano**. Congressman Sikorski, in all seriousness, I can speculate and have an opinion——

Mr. **Sikorski**. You already speculated that it was charitable. I'm wondering if——

Mr. **Serrano**. That was not a serious comment, but in all seriousness, we have made, always made an honest, very aggressive effort to enforce the spirit and letter of the Foreign Corrupt Practices Act, and we just simply do not know what General Yoon could possibly be doing.

Mr. **Sikorski**. Well, let me back it up. You gave a rationalization to staff, you and Ms. Carver gave a rationalization to staff, as I recall, as to what this money was involved in and that Mr. Yoon was underpaid based on your analysis of his expenditures and the rest of it. You certainly speculated on the high side as to the legitimacy of all this money.

At this point you stay away from any kind of thought as to whether there would be an improper use of this money in the Paris accounts.

Mr. **Serrano**. This is a very serious matter, and my speculations or opinions really don't count in something as serious as this.

Mr. **Sikorski**. I thank the Chairman.

Mr. **Dingell**. The gentleman from Texas.

Mr. **Bryant**. Mr. Serrano, has Mr. Veliotis or Mr. Gurr or anyone else in your organization ever speculated to you on what use General Yoon was making of the money you were paying him?

Mr. **Serrano**. No, sir. Mr. Veliotis, as I recall, had a very high opinion of Yoon's effectiveness as a good consultant in Korea.

Mr. **Bryant**. My question was——

Mr. **Serrano**. He never speculated as to any impropriety on Yoon's part.

Mr. **Bryant**. You are testifying under oath today that you have never had a conversation with anybody in the General Dynamics organization about whether or not Mr. Yoon was passing some of that money along under the table to some of those military fellows over there in South Korea, or bribing them?

Mr. **Serrano**. I certainly can recall no conversations to that effect.

Mr. **Bryant**. How about you, Mr. Chapman? Have you ever discussed what Mr. Yoon might be doing with the payments?

Mr. **Chapman**. I can definitely say that I never had a discussion with anybody about what Yoon was doing with the payments.

Mr. **Sikorski**. If the gentleman will yield.

Mr. **Bryant**. Yes.

Mr. **Sikorski**. Since the March hearing, it certainly had to be on people's minds, and I would anticipate that. I can see from your computer printout of the history with Yoon from the very beginning to the very end, and other people's dropping of Yoon, that someone in your organizations must have posited this as a hypothetical, at least. I don't want people saying under oath that they have never had a discussion even though they may have had them after they were alerted by these activities at the subcommittee.

Mr. **Chapman**. If I may respond to that, my answer was—did we have a discussion as far as unethical payments? And I did not participate in any discussions nor do I know of any discussions on unethical payments. That is what I was responding to Mr. Bryant.

Mr. **Bryant**. I think the gentleman's question is a very, very good one. It is hard to imagine that after this March hearing, that at General Dynamics you didn't have a discussion about what Mr. Yoon might be doing with those funds and what might show up if we began to investigate what he is doing with those funds.

Mr. **Serrano**. We were astounded at the allegations that were made. We said consider the source: A former officer of the company, who is the only one that I know of who has ever been involved in an impropriety where I have seen the evidence——

Mr. **Bryant**. I thought you just said Mr. Veliotis cited Mr. Yoon as being a good consultant. You were giving Mr. Veliotis' opinion to me as evidence of what kind of guy Mr. Yoon was. Now, are you going to complain about Mr. Veliotis?

Mr. **Serrano**. Yes, I would. I know Mr. Veliotis. On the point of did he ever say anything about impropriety that Yoon might be up to, other than the newspaper allegations, in any conversations I had with Mr. Veliotis, Mr. Veliotis never talked about impropriety, in fact, of any of our consultants.

Mr. **Bryant**. Mr. Chapman, I have only one last quesion, and that is: You made reference somewhere, in either the written material we have or maybe in your testimony, about awareness of the scandal that Mr. Yoon was involved in regarding the company he was president of before he founded the Buyeon Co., KTMI.

Mr. CHAPMAN. Tacoma Ship?

Mr. BRYANT. I think that was it. What were you referring to?

Mr. CHAPMAN. I do not know the nature of the scandal, but what I can say is when we were going through our background check of Buyeon Co., 1977, before we hired Buyeon as a consultant, we went to the U.S. Embassy. The U.S. Embassy indicated that there were no adverse effects from that scandal on either Buyeon, be it General Yoon or General Lee.

Mr. DINGELL. The time of the gentleman has expired.

The gentleman from Oregon.

Mr. WYDEN. Thank you, Mr. Chairman.

I just have one last question.

Ms. Carver, you apparently sat in with Ed Lynn in a meeting on June 9, 1982, when these contract negotiations were going on, and out of that set of contract negotiations, a company memo talked about various things that Mr. Yoon wanted in his contract, and apparently there was a feeling that these would cause problems, and the company said, "What if he dies, gets killed, or goes to jail?"

Now you sat in on that meeting, and there is a company memo specifically on this point.

My question to you is, what did the company think Mr. Yoon was involved with that might end up with him in jail or getting killed?

Ms. CARVER. Yes, Mr. Wyden, I was in the meeting with Ed Lynn on June 9. And the reason we even mentioned that at all is because we did not want to write this contract with an entity that did not include General Yoon.

Mr. WYDEN. You did not want to write this contract with an entity that included General Yoon?

Ms. CARVER. That's correct. If you will go on and read the rest of the counterproposal, what he was looking for was a 10-year contract. We discussed the possibility of a 5-year contract, but did not want to write a 5-year contract with a company that might not include General Yoon in 2½ years or 3 years for whatever reason. He could get hit by a car or whatever.

Mr. WYDEN. Well, why didn't the memo say something that would be along the lines of what we see generally, like if he had left the company? I mean, something like that strikes me as plausible, but I don't find this very garden variety language, that we just talk about what would happen if he gets killed or thrown in jail.

Ms. CARVER. It was merely a suggestion that was thrown in here. We discussed all of the possibilities of what could happen.

Mr. WYDEN. Well, it strikes me as a very odd way to put things, and it certainly gives me the impression that the company thought Mr. Yoon was involved in some things that could land him in jail or even get himself killed. And I think it would have been a lot more plausible and reasonable ways to go about dealing with the kind of thing that you're talking about.

Mr. Chairman, I don't have any further questions. As I said right at the outset, you know, it seems to me that the name of the game here is to keep the money moving around, so that its ultimate destination and ultimate purpose are never going to see the light of day. And I felt that at the beginning, and I feel that way now, and

I think it's a matter that we need to continue to examine, and I know you will do so in the days ahead.

Thank you, Mr. Chairman.

Mr. DINGELL. The Chair thanks the gentleman.

Ladies and gentleman of the panel, we thank you for your participation.

The subcommittee will stand adjourned until the call of the Chair.

[Whereupon, at 2:50 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

FEDERAL SECURITIES LAWS AND DEFENSE CONTRACTING

Offsets Associated With Foreign Military Sales

THURSDAY, OCTOBER 10, 1985

House of Representatives,
Committee on Energy and Commerce,
Subcommittee on Oversight and Investigations,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2322, Rayburn House Office Building, Hon. John D. Dingell (chairman) presiding.

Mr. Dingell. The subcommittee will come to order.

The Chair notes presence for the purpose of taking testimony. The Chair, by way of opening statement, observes that the function of the subcommittee is under the rules of the House, specifically rules 10 and 11, which vests this committee as a Subcommittee on Oversight and Investigations with jurisdiction over matters involving interstate and foreign commerce generally.

The subcommittee and the committee also have responsibility for the adequate and effective enforcement of the securities laws and the oversight of the Securities and Exchange Commission.

Since 1981, this subcommittee has inquired into the difficulties experienced by U.S. companies as a result of unfair foreign trade practices. We have developed an extensive record of those practices, and highlighted the threat they pose to American jobs and the markets for American products at home and abroad.

The subcommittee has issued a number of reports on unfair trade practices and endorsed a number of legislative proposals aimed at ending the unfair advantage enjoyed by some of our foreign competitors, a new aspect of the problems the subcommittee has been working on. We will focus most specifically on the roles foreign military sales play in this matter and their impact on American industry.

According to officials in the Department of Defense and the defense contractors, foreign sales of billions of dollars in weapons systems are an annual boon to both the U.S. economy and our balance of payments of this Nation. Testimony today will show that the conventional wisdom is simply not true. Most of these alleged benefits are bartered away by defense contractors in their eagerness to make deals with the foreign country.

Most foreign military sales today involve a combination of barter, substantial U.S. taxpayer subsidies, and direct payments, export of U.S. technology, and creation of new and substantial competitors overseas. In trade terminology, these arrangements are called direct and indirect offsets, and U.S. Government foreign military sales credits.

Many developed and developing countries that buy U.S. weapons systems today demand close to 100 percent offsets in excess of 100 percent with no net benefit to U.S. balance of payments. Indeed, they appear to offer significant adverse impact on the U.S. balance of payments, in many specific instances, and perhaps overall.

As a result of these offsets, many major defense contractors find themselves worldwide peddlers of shoes, textiles, grapes, wine, furniture, cosmetics—to cite only a few imported products that displace American products in U.S. markets.

General Dynamics, McDonnell Douglas, and other giant defense firms are finding themselves becoming glorified travel agents for foreign governments promoting tourism in Canada, Australia, Greece, Turkey, Spain, and a host of other countries—as part of their offset deals. This has been a vast undertaking, and the scope of these events defies the understanding of the subcommittee, but it is enormous.

The subcommittee has tried to define and to understand the effect on employment in the United States. The Chair will observe that our findings are that a result of these events appear to be extremely adverse from the standpoint of U.S. jobs and U.S. industries.

The U.S. Government today is totally in the dark on the level of indirect offsets negotiated by major defense contractors. Although the amounts involved run into the billions of dollars each year, it appears that no one really looks at these matters or understands their consequences with regard to jobs, employment, and opportunity for the American people.

Indeed, it may be observed that the total overall effect of these events is distinctly adverse to the long-term interest of the United States because it is not beyond the realm of possibility that a strong case could be made that these contracts and contractors are, in fact, deindustrializing the United States. Inexplicably, there is not adequate government data on the extent of indirect offsets or the resulting impact on the balance of payments or on employment in the United States.

Currently, there are two studies underway by the Federal Government which attempt to identify the level and impact of offsets involved in defense sales. One is being conducted by the International Trade Commission, and the other by the Office of Management and Budget. We all know what a dark hole the Office of Management and Budget is. We will have testimony today concerning the results of the International Trade Commission study. Last Friday, OMB requested a 2-month delay in its report which was to be delivered to the Congress next week.

A good example of how the offset systems work is the $4.2 billion sale by General Dynamics of 160 F-16's to Turkey. The sale involved foreign military sales credits at concessionary rates. General Dynamics agreed to peddle over 1 billion dollars' worth of Turkish goods and to make over $100 million in direct investments to Turkey.

Because of an earlier F-16 sale in Europe, 15 percent or $600 million of the production goes to the European participating governments. So we will be essentially paying a royalty of 15 percent to European governments in connection with this sale.

Last, General Dynamics is entering into a joint venture with the nonexistent Turkish aerospace industry to coproduce the F-16 in Turkey. Of the 160 aircraft to be sold under what is being touted as a bonanza for American industry, only 10 will be made in the United States. The other 150 will be made in substantial part in Turkey. One can only be driven to the conclusion that this means a potential export of U.S. jobs at a time when U.S. trade balances are being projected at being $150 billion to $170 billion in deficit.

Turkey has less than 100 people in its aerospace company, has never built an airplane, and there is no trained labor force in that country. One of the more significant contributions to the joint venture to produce the F-16 is an open field where General Dynamics is expected to build an assembly plant, which obviously can be anticipated as a continuing future competitor for the U.S. aerospace industry.

It thus appears there is a new and a peculiar aspect of foreign military sales today.

The subcommittee has other evidence of interesting and curious examples from a study of the offsets program. As a part of the European production group deal, Pratt & Whitney is required to set up manufacturers for Pratt and Whitney engines in Europe. These firms will be and are currently competiting with Pratt & Whitney for U.S. Air Force contracts in the United States.

In a deal with McDonnell Douglas, the Japanese coproduced the F-15 in Japan. This along with other coproduction arrangements, led to substantial technology transfers to Japan, resulting in Japan acquiring close to 10 percent of the international aerospace market.

It puts Japan well on the way to achieving its declared goal of 30 percent of the international aerospace business in the immediate future. Lockheed recently sold some planes to Canada and was paid in part with office furniture produced in Canada that was then imported into the United States, in competition with U.S. furniture producers.

One may observe that this action had significant adverse impact upon the U.S. furniture industry. One defense contractor may very well in the immediate future wind up rivaling Gucci, and Pappagalo as one of the world's foremost shoe marketers, because of its offset commitments to Brazil.

Another contractor returned from a successful arms peddling venture with a boatload of hams in payment. One must ask how that will be received and how much enthusiasm can be discerned in Iowa or in other hog producing parts of the United States.

In a recent sale of the F-16 to Greece, the capability of the aircraft became almost irrelevant. The final deal was negotiated, not by the Greek military, but by the Minister of Industries. The decision was based on which contractor could do the most for the sick industries in Greece, a splendid, and I believe, appropriate concern by the Greek Ministry, but one must ask whether this has conferred significant benefits upon sick industries of the United States or upon the United States balance of payments defict which is exploding to $150 billion or $170 billion this year.

Of the developed countries with which the United States has trade deficits of enormous size, Japan, Canada, and Korea, amongst others, are demanding substantial offsets which will contribute to continued and expanding deficits of the United States in our trade balance with those countries and others.

Offsets are clearly causing distortions in the U.S. economy. There may be some apparent U.S. employment benefits accruing to the U.S. defense firms, probably only in the short run. But the United States is exporting through this device significant numbers of jobs in other segments of the economy as a result of the offsets negotiated by the defense contractors. It is important from a public policy point of view to better understand this phenomenon and the impact on the U.S. economy and American businesses.

It is clear there are no simple answers to the issues raised by these increasing offsets. The first step in understanding the problem, is the character and the extent of the problem. We must then move toward an understanding of the range of potential solutions, and we must get, of course, the facts on the level of offsets, their impact on the U.S. economy, and the benefit, if any, conferred on the United States and its workers by these arrangements.

Our first panel today includes Dr. Paula Stern, Chairman, International Trade Commission and Mr. Frank Conahan, Director, National Security and International Affairs Division, of the General Accounting Office.

Dr. Stern, and Mr. Conahan, we thank you both for being with us today and for your assistance to the committee. If you would come forward and take your seats.

Before we recognize you the Chair will recognize the gentleman from Oregon for an opening statement and then the gentleman from Ohio, and the gentleman from Texas.

Mr. Wyden. Thank you very much, Mr. Chairman.

I have just a couple of comments, first of all to commend you and our staff and the GAO for a superlative job. It seems what the evidence that has been accumulated already indicates, that we are just lurching from one sale to the next without any clear purpose or any real idea whether the sales are truly in the national interest and in line with any national policy.

I think it is really the height of irresponsibility, given the fact we have got a number of Federal agencies that have or should have a prominent role and a vital stake in how those deals are put together, that these Federal agencies have never come up with a comprehensive approach to managing offsets.

The fact is we couldn't even have a single agency that is out there monitoring these offsets activities. I think this is extremely depressing news given the impact on our economy and the cost effectiveness, the way the defense dollar is allocated, and I very much appreciate, Mr. Chairman, your holding these hearing so we can explore how to turn this situation around.

I think we all understand that in some instances these kinds of inducements may be necessary to compete in the international arms market or to further our strategic interest but it has got to be done in line with some clearly defined national policy. There isn't one.

Instead we just move on an ad hoc basis from one sale to another, and I think are doing ourselves a disservice, both in terms of our defense needs and in terms of our needs to employ our citizens.

Thank you very much.

[The prepared statement of Mr. Wyden follows:]

STATEMENT OF HON. RON WYDEN

Mr. Chairman, we will explore this morning a little understood facet of our nation's defense policy, foreign policy and military production policy—the use of offsets, both direct and indirect, to facilitate military sales to foreign countries.

Although we have only a limited understanding of how or why this system works, the implications—for our domestic economy and for our national security and strategic interests—are substantial. The key question is whether or not these various offset mechanisms truly serve our strategic and economic interests both at home and abroad.

The answer to that very basic question, unfortunately, is that no one really knows. That's because there is no coordinated, well thought out U.S. policy in this area. In fact, as the GAO will point out, not only does the U.S. lack a comprehensive approach to managing offsets, no single agency has even been assigned to monitor offset activities.

These intricate agreements are put together on a case by case, ad hoc basis from country to country and from weapons system to weapons system. Sometimes we barter away technology, sometimes jobs, sometimes market share for various products in our own domestic economy, sometimes direct taxpayer-financed inducements in the form of Foreign Military Sales credits. Undoubtedly, there are times when such inducements are necessary to compete in the international arms market or to further our strategic interests. What we do in essence, however, is lurch from one sale to the next with no clear purpose, no real idea of whether or not a particular sale is truly in the national interest and no overriding or controlling policy goals.

Thanks to another fine job by the General Accounting Office, I expect we will learn a lot about offsets and foreign military sales this morning. I hope we can also start to figure out why the several federal agencies that have, or should have, a prominent role and prominent stake in how these deals are put together have failed to develop any sort of coordinated national policy on offsets. Then, perhaps, this Subcommittee and the Congress as a whole will be able to formulate some suggestions on just what our long term national goals and policy in this critically important area should be. Thank you very much.

Mr. DINGELL. The gentleman from Ohio.

Mr. LUKEN. Mr. Chairman, I think you have covered this very well.

I would just observe that these offsets represent the ultimate irony in our international trade situation, that in the one area where we are the producers, the merchants, and the financers of arms and equipment, that those who are the beneficiaries are making demands and succeeding in those demands which are having a very bad effect upon our trade, our competitiveness overseas.

I think as usual the chairman has put his finger on it, has been following the process, and this hearing and further developments may enable us to do something about it.

Thank you very much.

Mr. DINGELL. The Chair thanks the gentleman.

The gentleman from Texas.

Mr. BRYANT. Mr. Chairman, I have no opening statement other than to again congratulate the chairman on the leadership in keeping this subcommittee and our full committee in the forefront, on the cutting edge, of grappling with significant and threatening developments with regard to our entire Government and particularly with regard to trade.

Once again we are out front dealing with a problem that few know about and even fewer understand and I appreciate the chairman's leadership.

Mr. **Dingell**. Dr. Stern, Mr. Conahan, the Chair wants to begin by expressing the thanks of the subcommittee for your great assistance to us.

Does the gentleman from Minnesota have an opening statement?

Mr. **Sikorski**. No, I don't. Thank you very much.

Mr. **Dingell**. It has been the practice of this subcommittee since it was first established under Sam Rayburn that all witnesses are sworn prior to the time that they give testimony.

Mr. Conahan, Dr. Stern, do either of you object to being sworn?

Mr. **Conahan**. No.

Ms. **Stern**. No.

Mr. **Dingell**. The Chair will advise that copies of the rules of the subcommittee and the rules of the House are there before you in compliance with the rules to define the limits on the powers of the subcommittee and also to delineate clearly your rights.

Dr. Stern and Mr. Conahan, do either of you or any of your associates desire to have legal counsel as you appear before the committee this morning?

It is your right.

Ms. **Stern**. No, sir.

Mr. **Conahan**. No, sir.

Mr. **Dingell**. Then if you would each please rise and raise your right hand.

Do you solemnly swear the testimony you are about to give this morning is the truth, the whole truth?

Ms. **Stern**. I think Mr. Ron DeMarines, who is accompanying me will probably be helping with questions, so he should be sworn?

Mr. **Dingell**. Ms. McCabe and Ms. D'Agostino, you as well?

Would you raise your right hand?

[Witnesses sworn.]

Mr. **Dingell**. You may each consider yourselves to be under oath, and the Chair wishes to express the thanks of the subcommittee to your associates, Dr. Stern and Mr. Conahan; Mr. DeMarines; Ms. McCabe; and Ms. D'Agostino, we thank you for your assistance to the committee.

We will recognize you first, Dr. Stern, for your statement.

Again the Chair expresses its thanks of the committee for your assistance to us and your presence this morning.

TESTIMONY OF PAULA STERN, CHAIRWOMAN, INTERNATIONAL TRADE COMMISSION, ACCOMPANIED BY RONALD DE MARINES, CHIEF, MACHINERY AND TRANSPORTATION EQUIPMENT BRANCH; AND FRANK C. CONAHAN, DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE

Ms. **Stern**. Thank you very much.

It is a pleasure to be here to have the opportunity to testify before this subcommittee on the subject of military offsets.

As I said, accompanying me is Mr. Ron DeMarines, who was the project leader for the International Trade Commission's recently completed study on countertrade and offsets. It is important, I think, as the lead-off witness at today's hearing, that I begin by describing some ground rules, and terminology of countertrade, and more specifically of offsets associated with military sales.

First of all one must understand that there is a basic difference in the way the military establishment and those involved in nonmilitary trade view offsets. The later generally use countertrade as the all encompassing term to describe all types of reciprocal or linked international trade actions, including offsets.

Those involved in military trade, however, hewing to the fine old tradition that there is a right way, a wrong way, and the Army way, treat offsets as the umbrella term and countertrade as its subset, a priority that I might say Noah Webster's successors do not accept. But in any case, this is the terminology that we are going to be working with.

No matter which term ranks first in the hierarchy of linked international transactions, the basic elements of offsets remain unchanged. These elements may include one or more of the following:

Coproduction; licensed production; subcontractor production; overseas investment; and technology transfer.

Offsets can be further classified into direct offsets, indirect offsets, or a combination.

Direct offsets include any business that relates directly to the product being sold. An example of this would be when a portion of the product being sold, such as the landing gear for an aircraft, would be produced in the buying country by local vendors.

Indirect offsets refer to all business unrelated to the product being sold, but which is nonetheless linked as a contractual or best effort commitment to the original military sale.

On June 11, 1984, the Commission began is assessment of the barter and countertrade transactions on U.S. industries. In a survey conducted as part of that study the Commission received responses from 154 U.S. defense equipment producers, including those that are principally subcontractors to major defense suppliers.

The Commission study used three criteria in order to measure the magnitude of military offsets. The first criterion was the total export value of the sales agreement with which offset commitments are associated. The second measure was the value of the actual offset obligations associated with the export sales contracts.

In a military export sale the obligation agreement may be signed at the time the export sales agreement itself is signed but the signing is more likely to occur at a later date, perhaps as long as 2 or 3 years after the original sale is made.

The third measure by which we measured this practice is the value of the offset obligations actually fulfilled annually.

Fulfillment of the obligations tends to vary in proportion to the value of the obligation and may take more than 10 years to complete.

Respondents to the Commission survey indicated that the value of signed military export sales agreements with which offsets were associated, which is that first measure of offset magnitude, totaled $22.5 billion during our survey period of 1980 through 1984.

Now, the detailed data is on table 1, appendix A, of the full statement that I provided earlier.

Mr. DINGELL. Without objection that will be inserted at the appropriate place, as will be your full statement, Doctor.

Ms. STERN. More than 80 percent of the reported value of military export sales agreements involved aerospace production and offsets were associated with roughly half of the total military related export sales reported by those respondents.

Total military related export sales during the period were $47.8 billion. Export sales agreements containing an offset agreement were subject to significant year-to-year swings.

They were at their highest level, $6.6 billion and 94 percent of military sales—in 1980 and their lowest—$732 million and 7 percent of sales in 1982.

The severe annual fluctuation in the value of reported military related export sales are a refletion of the sporadic flow of major weapons purchases by foreign governments. It is important to bear in mind that this data represents a signed contract, and not actual shipments. Now, the most significant measure of the magnitude of offsets is the second measure.

That is the value of the the offset obligations associated with export sales agreement. According to the respondents the Commission surveyed total offset obligations signed during the survey period were signed at $8.8 billion.

That $8.8 billion of offset obligations signed in the years 1980 through 1984 represent 38 percent of the value of export sales agreements signed during the entire period.

Because offset obligations may be signed 2 or 3 years after the export sales is made some of the obligations were associated with the 1982 through 1984 export sales may not have been signed during the survey period and, therefore, our total probably understates the volume and the value of the activity that we were studying.

Aircraft, guided missiles and other aerospace products were most involved in the offset obligations as they accounted for the greatest portion of the face value of the sales agreements. The average offset to sales ratio steadily increased from 6 percent in 1980 to a peak of 76 percent in 1983, and it then declined to 37 percent in 1984.

I refer you to figure 1 of appendix 8, to show that year-to-year ratio differentiation. Data from the Commissions survey revealed that during 1980 through 1983, U.S. firms were accepting larger offset obligations in the face of increased international competition for military related export sales.

The decline in obligations to sales ratio for 1984 was not necessarily the indication of a declining obligation to sales trend, but rather, I think, a reflection of the fact that not all obligations associated with the 1984 sales had been signed by the end of 1984. Although most of the offset obligations were assumed by the prime contractors, in many instances there were major subcontractors who were also asked to share some portion of the offset burden.

This shared arrangement is often advantageous for both the prime contractor and the subcontractor since both have much to gain if the prime contractor is awarded the export sales contract.

Sometimes the subcontractors may negotiate an offset obligation directly with the buyer on behalf of the prime contractor.

During 1980 through 1984 subcontractors assumed almost $1 billion or 11 percent of the prime contractor's obligations.

Now, the third and last measure of offset significance is the fulfillment of the obligations.

Since fulfillment may take as long as 10 years to complete it is not surprising that fulfillment of obligations signed during the 1980-84 period amounted to slightly less than $3 billion or only 31 percent of total obligations. More than half of the offset fulfillment was in the aircraft and parts category.

The Commission study found, I think, several interesting consequences or reported consequences resulting from the growth of offset arrangements. The majority of the respondents who answered our survey engaging in military offsets indicated they think they have been able to maintain or increase existing levels of employment and plant capacity because of the new business generated by the contracts that are containing those offsets.

Other benefits that they reported from the added business resulting from contracts awarded as a result of U.S. corporations' willingness to accept these offsets included larger and more efficient production runs, lower unit costs, increased capital formation, and the development of new technology. Again, according to the respondents to our survey, offsets have not necessarily adversely affected the competitiveness of their companies.

They have, however, concern over the potential impact on their business from competition emerging from these offset transactions. This concern arises from the offset requirements, for example, for technology transfer or for foreign procurement which will result in the creation of new competitors down the line.

Although these reported positive aspects of offsets seem to have outweighed the negative aspects of these transactions, I do think it is important to mention one rather significant downside effect. U.S. companies reported that 31 contracts totaling a billion dollars were lost during the 1980 to 1984 period because of these offset requirements, and the primary reason given for those lost sales was that individual corporate policies prohibited or discouraged the use of offsets.

To a lesser extent the sales were lost to foreign competitors that offered more competitive offset proposals. As a result of offet fulfillment through 1980 to 1984 new foreign competitors were created that do have the potential of displacing U.S. goods and services.

The most significant of the new sources of nondefense related goods and services occurred in the area of electronic components and accessories where several new sources of competition emerged. I refer you to table 5, of appendix 8, on that.

These new sources were Australia, Israel, and the Republic of Korea for defense related goods and services. New or enhanced sources emerged in the manufacturer of aircraft and parts, turbines and engines. Again, Australia and Israel were most named as new sources of supply for defense related products and services followed by Denmark, Norway, and the United Kingdom.

I should point out that the value of imports associated with military offsets is less than 1 percent of total U.S. imports.

Mr. Chairman, this concludes my summary of the Commission's study.

Military offsets remain a small part of our overall trade picture, but they also raise very significant, very important policy questions. Often presented as a reality that U.S. exporters cannot ignore, offsets may hinder our long-term competitiveness and adversely affect other U.S. companies.

I hope that our factfinding study has shed some much needed light on this activity of military offsets.

[Testimony resumes on p. 321.]

[The prepared statement and attachments of Ms. Stern follow:]

DR. PAULA STERN, CHAIRWOMAN
U.S. INTERNATIONAL TRADE COMMISSION

Good morning Mr. Chairman.

Thank you very much for giving me the opportunity to testify before this Subcommittee on the subject of military offsets. Accompanying me today is Ron DeMarines, the project leader for the Commission's recently completed study on countertrade and offsets.

I will begin my testimony with some basic definitions used in discussing offsets. Then I will summarize the results of the Commission's study as they relate to the volume and nature offsets associated with military related exports. I will also discuss the study's findings regarding the impact offset requirements on U.S. companies.

It is important as the lead off witness at today's hearing that I begin by describing ground rules of countertrade and more specifically of offsets associated with military sales. First of all, one must understand that there is a basic difference in the way the military establishment and those involved in nonmilitary trade view offsets. The latter generally use countertrade as the all-encompassing term to describe all types of reciprocal or "linked" international trade transactions, including offsets. Those involved in military trade, hewing to the fine old tradition that there's a right way, a wrong way and the Army way, treat "offsets" as the umbrella term and countertrade as its subset—a priority that Noah Webster's successors do not accept.

No matter which term ranks first in the hierachy of "linked" international transactions, the basic elements of offsets remain unchanged. These elements may include one or more of the following:

- Co-production: Overseas production based upon a government-to-government agreement that permits a foreign government or producer to acquire the technical information to manufacture all or part of a

U.S.-origin defense article. It includes government-to-government licensed production and excludes licensed production based upon direct commercial arrangements by U.S. manufactures.

- Licensed production: Overseas production of part of a U.S.-origin defense article based upon transfer of technical information under direct commercial arrangements between a U.S. manufacturer and a foreign government or producer.

- Subcontractor production: Overseas production of a part or component of a U.S.-origin defense article. The subcontract does not necessarily involve license of technological information and is usually a direct commercial arrangement between the U.S. manufacturer and a foreign producer.

- Overseas investment: Investment arising from the offset agreement, usually taking the form of capital invested to establish or expand a subsidiary or joint venture in the foreign country for the production of component(s) of the defense article.

- Technology transfer: As a result of an offset agreement, research and development may be conducted abroad; technical assistance may be provided to the subsidiary or the joint venture partner; or other activities under direct commercial arrangement between the U.S. manufacturer and the foreign entity may be entered into.

Offsets can also be classified into direct offsets, indirect offsets, or a combination of the two.

Direct offsets include any business that relates directly to the product being sold. An example of this would be when a portion of the product being sold, such as the landing gear for an aircraft, would be produced in the buying country by local vendors.

Indirect offsets refers to all business unrelated to the product being sold but which is nonetheless "linked" as a contractual or best effort commitment to the original military sale.

As you know, the U.S. Government has undertaken two major studies of countertrade and offsets. On June 11, 1984, the Commission began its Assessment of the Effects of Barter and Countertrade Transactions on U.S. Industries. Concurrant with the Commission's investigation, Congress enacted the Defense Production Act Amendments of 1984 (Public Law 98-265) which amended the Defense Production Act of 1950 (50 U.S.C. App. 2061).

The 1984 law added section 309 to the Defense Production Act. Section 309 requires the President, not later than 18 months after the date of enactment to submit to the Committee on Banking Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing and Urban Affairs of the Senate a report on the impact of offsets on the defense preparedness, industrial competitiveness, employment, and trade of the United States. The President directed the Office of Management and Budget (OMB) to coordinate preparation of the section 309 study of the impact of offsets.

Both the OMB and the Commission intended to survey U.S. corporations. The Commission's intentions were to survey corporations involved in all variations of countertrade including offsets while the intended OMB survey was only to survey corporations involved in offset arrangements associated with military-related export sales. Citing the potential burden on corporations responding to two similar questionnaires, the OMB requested, and the Commission agreed, that the Commission alone gather the necessary information for both investigations. The Commission issued a questionnaire developed jointly by the Commission and OMB. Information on offsets from the questionnaire was provided to OMB in July of this year. The Commission received responses from 154 U.S. defense equipment producers including those that are principally subcontractors to major defense suppliers.

The Commission's study used three criteria to measure the magnitude of military offsets:

1. The total export value of sales agreements with which offset commitments are associated.
2. The value of the actual offset obligations associated with the export sales contracts. In a military export sale, the obligation agreement may be signed at the time the export sales agreement itself is signed but the signing is more likely to occur at a later date, perhaps as long as two to three years after the original sale.
3. The value of the offset obligations actually fulfilled annually. Fulfillment of obligations tends to vary in proportion to the value of the obligation and may take more than 10 years to complete.

Respondents to the Commission's survey indicated that the value of signed military export sales agreements with which offsets were associated - the first measure of offset magnitude - totaled $22.5 billion during the survey period of 1980-84. The detailed data are in table 1, appendix A of this statement. More than 80 percent of the reported value of military export sales agreements involved aerospace products, and offsets were associated with roughly half of the total military-related export sales reported by the respondents. Total military-related export sales during this period were $47.8 billion.

Export sales agreements containing an offset agreement were subject to significant year-to-year swings. They were at their highest level—$6.6 billion and 94 percent of military sales—in 1980 and their lowest—$732 million and 7 percent of sales in 1982. The severe annual fluctuation in the value of reported military related export sales are a reflection of the sporadic flow of major weapons purchases by foreign governments.

It is important to bear in mind that these data represent signed contracts and not actual shipments. Actual shipments of military related products may lag behind the signing of the sales contract by as much as three years.

A regional breakdown given in table 2 of appendix A, shows that, military related U.S. corporate sales to NATO-Europe countries accounted for $8.3 billion during 1980-84. Export sales to Asian countries, including Israel, Japan, and Turkey, accounted for $7.3 billion, while export sales to all other countries were valued at $6.4 billion. The "all other" category was heavily influenced by offsets with Canada and Australia.

The most significant measurement of the magnitude of offsets is the second one: the value of the offset obligations associated with export sales agreements. According to respondents to the Commission's survey, total offset obligations signed during the survey period were valued at $8.8 billion. (It is important again to keep in mind that the offset obligation, like the export sales contract, is a contractual agreement and does not represent actual product shipments.)

The $8.8 billion of offset obligations signed during 1980-84 represents 39 percent of the value of the export sales agreements signed during this period. Because, as I stated earlier, offset obligations may be signed two to three years after the export sale, some obligations associated with 1982-84 export sales may not have been signed during the survey period, and our total probably understates the volume and value of activity. Aircraft, guided missiles, and other aerospace products were most likely to be involved in the offset obligation, just as they accounted for the greatest portion of the face value of the sales agreements.

NATO-Europe accounted for more than half (or $4.6 billion) of all reported offset obligations signed during 1980-84 (see table 3 in appendix A) while Asian countries (including Middle East countries such as Israel and Turkey) accounted for 20 percent of total obligations. Offset obligation with all other countries accounted for the remaining 20 percent.

In comparing offset obligations with total military-related export sales agreements, the Commission found that this offset-to-sales ratio averaged almost 60 percent in U.S. transactions with NATO-Europe. In other words, offset obligations accounted for almost 60 percent of the value of military-related export sales in which offsets were agreed to.

Again, please bear in mind that the value of obligations are understated for the reason I mentioned earlier. Therefore, the offset-to-sales ratios presented here understate the actual levels. With respect to such sales to Asian countries and the group of "all other" countries, offset obligations were only about 20 percent each of total sales.

The average offset-to-sales ratio steadily increased from six percent in 1980 to a peak of 76 percent in 1983 and then declined to 37 percent in 1984 (see figure 1 of appendix B). Data from the Commission's survey reveal that during 1980-83, U.S. firms were accepting larger offset obligations in the face of increased international competition for military-related export sales.

The decline in obligations-to-sales ratio in 1984 was not necessarily an indication of a declining obligation-to-sales trend, but rather a reflection of the fact that not all obligation associated with 1984 sales had been signed by the end of 1984.

Please refer to table 4 in appendix A for a listing of the product categories associated with offset obligations. These product categories include aircraft and parts, engines and turbines, office machines, and communication equipment.

Although most of the offset obligations were assumed by the prime contractors, in many instances, major subcontractors were also asked to share some portion of the offset burden. This shared arrangement is often advantageous for both the prime and the subcontractor, since both have much to

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gain if the prime is awarded the export sales contract. Sometimes the subcontractors may negotiate an offset obligation directly with the buyer on behalf of the prime. During 1980-84, subcontractors assumed almost $1 billion or 11 percent of their primes' obligations.

The third measure of offset significance in addition to the export sale and the obligation values, is the actual fulfillment of the obligation. Since fulfillment may take as long as 10 years to complete, it is not suprising that fulfillment of obligations signed during 1980-84 amounted to slightly less than $3 billion or only 31 percent of total obligations. More than half of offset fulfillment was in the aircraft and parts category.

The Commission study found several interesting consequences resulting from the growth of offset arrangements. The majority of respondents engaging in military offsets indicated that they have been able to maintain or increase existing levels of employment and plant capacity because of new business generated by contracts containing offsets. Other benefits from the added business resulting from contracts awarded as a result of U.S. corporations' willingness to accept offsets include larger and more efficient production runs, lower unit costs, increased capital formation, and the development of new technology. According to respondents to the Commission's survey, offsets have not adversely affected the competitiveness of their companies. However, some U.S. companies expressed concern over the potential impact on their business from competition emerging from offset transactions. This concern arises from offset requirements for technology transfer, and foreign procurement, resulting in the creation of new competitors.

Although the reported positive aspects of offsets outweighed the negatives of such transaction, I feel it is important to mention one rather significant downside effect. U.S. companies reported that 31 contracts, totaling $1 billion, were lost during 1980-84 because of offset requirements. The primary reason given for these lost sales was that individual corporate policies prohibit or discourage the use of offsets. To a lesser extent, these sales were lost to foreign competitors that offered more competitive offset proposals.

As a result of offset fulfillment during 1980-84, new foreign competitors were created that have the potential of displacing U.S. goods and services. The most significant of the new sources of non-defense-related goods and services occurred in the area of electronic components and accessories, where seven new sources emerged (see table 5 in appendix A). These new sources were mainly in Australia, Israel, and the Republic of Korea. For defense-related goods and services, new or enhanced sources emerged in the manufacture of aircraft and parts, turbines, and engines (see table 6). Australia and Israel were most named as new sources of supply for defense-related products and services, followed by Denmark, Norway, and the United Kingdom. I should point out that the value of imports associated with military offsets are less than one percent of total U.S. imports.

Mr. Chairman, this concludes my summary of the Commission's study. Military offsets remain a small part of our overall trade picture, but they also raise important policy questions. Often presented as a reality that U.S. exporters cannot ignore, offsets may hinder our long-term competitiveness and adversely affect other U.S. companies. I hope that our fact finding study has shed some much-needed light on military offset activity.

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APPENDIX A

Table 1.—Reported value of respondents' total U.S. military-related export sales, and the reported value of U.S. military-related export sales associated with offsets, 1980-84

Year	Collective U.S. military export sales (million dollars)	Collective face value of sales contracts associated with a military related sale involving offsets (million dollars)	Ratio of sales contract with a military-related export sale to total U.S. military export sale (Percent)
1980——	6,964	6,568	94
1981——	8,907	4,919	55
1982——	10,315	732	7
1983——	10,428	4,377	42
1984——	11,222	5,890	52
Total or average—	47,835	22,486	47

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Table 2.—Total value of goods and services to be supplied in sales agreements in which offsets were negotiated, by regions, and years contracts signed, 1980-84

(In millions of dollars)

Region	1980	1981	1982	1983	1984	1980-84
Europe:						
NATO countries—	2,434	874	212	3,339	1,398	8,257
Non-NATO countries——	158	328	40	52	17	595
Subtotal——	2,592	1,202	252	3,391	1,415	8,852
Asia——	1,335	835	63	718	4,301	7,254
All others——	2,641	2,880	417	269	174	6,381
Total——	6,568	4,919	733	4,378	5,891	22,489

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Note.—Because of rounding, figures may not add to the totals shown.

Table 3.—Collective value of offset obligation, by regions and years offset agreements were entered into, 1980-84

(In millions of dollars)

Region	1980	1981	1982	1983	1984	1980-84
Europe:						
NATO countries	159	275	52	3,024	1,128	4,638
Non-NATO countries	-	300	106	40	93	539
Subtotal	159	575	158	3,064	1,221	5,177
Asia	236	553	98	160	799	1,846
All others	15	1,423	183	20	162	1,803
Total	413	2,551	440	3,244	2,182	8,830

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Note.—Because of rounding, figures may not add to the totals shown.

Table 4 .--Products associated with countertrade sales agreements, countertrade obligations, or fulfillment of countertrade obligations, by types of occurrences, 1980-84 and 1985-2000

Product description (3-digest SIC code)	Sales agreements with military offset obligations of less than $2 million, 1980-84	Sales agreements associated with military offset obligations of $2 million or more, 1980-84	Military offset obligations of more than $2 million, 1980-84	Military offset obligations of $2 million or more during fulfilled, 1980-84
Unspecified				
Field crops, except cash grains (13)				
Vegetables and melons (16)				
Fruits and tree nuts (17)				
Commercial fishing (91)				
Iron ores (101)				
Bauxite and other aluminum ores (105)				
Ferroalloy ores, except vanadium (106)				
Miscellaneous metal ores (109)				
Crude petroleum and natural gas (131)				
Oil and gas field services (138)				
Crushed and broken stone, including riprap (142)				
Clay, ceramic, and refractory minerals (145)				
Chemical and fertilizer mineral mining (147)				
Nonmetallic minerals (except fuels) services (148)				
Miscellaneous nonmetallic minerals, except fuels (149)				
General building contractors-nonresidential buildings (154)				
Heavy construction except highway and street construction (162)			X	
Roofing and sheet metal work (176)				

Table 4 .--Products associated with countertrade sales agreements, countertrade obligations, or fulfillment of countertrade obligations, by types of occurrences, 1980-84 and 1985-2000--Continued

Product description (3-digest SIC code)	Sales agreements with military offset obligations of less than $2 million, 1980-84	Sales agreements associated with military offset obligations of $2 million or more, 1980-84	Military offset obligations of more than $2 million, 1980-84	Military offset obligations of $2 million or more during fulfilled, 1980-84
Miscellaneous special trade contractors (179)		X	X	X
Canned and preserved fruits and vegetables (203)				
Cigarettes (211)				
Tobacco (chewing and smoking) and snuff (213)				
Narrow fabrics and other smallwares mills: cotton, wool, silk, and manmade fiber (224)				
Miscellaneous textile goods (229)				
Miscellaneous fabricated textile products (239)				X
Office furniture (252)			X	X
Paper mills, except building paper mills (262)				
Building paper and building board mills (266)	X			
Newspaper: publishing, publishing and printing (271)				
Commercial printing (275)				X
Service industries for the printing trade (279)				X
Industrial inorganic chemicals (281)				
Plastics materials and synthetic rubber, synthetic and other manmade fibers, except glass (282)			X	X
Drugs (283)				
Soap detergents and cleaning preparations, perfumes, cosmetics, and other toilet preparations (284)				X

Table 4 .--Products associated with countertrade sales agreements, countertrade obligations, or fulfillment of countertrade obligations, by types of occurrences, 1980-84 and 1985-2000--Continued

Product description (3-digest SIC code)	Sales agreements with military offset obligations of less than $2 million, 1980-84	Sales agreements associated with military offset obligations of $2 million or more, 1980-84	Military offset obligations of more than $2 million, 1980-84	Military offset obligations of $2 million or more during fulfilled, 1980-84
Industrial organic chemicals (286)				
Agricultural chemicals (287)	X			
Micellaneous chemical products (289)				X
Petroleum refining (291)				
Tires and inner tubes (301)				
Rubber and plastics hose and belting (304)				
Miscellaneous plastics products (307)				X
Footwear, except rubber (314)				X
Handbags and other personal leather goods (317)				
Glass and glassware, pressed or blown (322)				
Cut stone and stone products (328)				
Abrasives, asbestos, and miscellaneous nonmetallic mineral products (329)				
Blast furnaces, steel works, and rolling and finishing mills (331)				
Iron and steel foundries (332)				X
Rolling, draining, and extruding of nonferrous metals (335)				X
Nonferrous foundries (castings) (336)				X
Miscellaneous primary metal products (339)				X
Cutlery, handtools, and general hardware (342)			X	X
Fabricated structural metal products (344)	X	X	X	X

Table 4.--Products associated with countertrade sales agreements, countertrade obligations, or fulfillment of countertrade obligations, by types of occurrences, 1980-84 and 1985-2000--Continued

Product description (3-digest SIC code)	Sales agreements with military offset obligations of less than $2 million, 1980-84	Sales agreements associated with military offset obligations of $2 million or more, 1980-84	Military offset obligations of more than $2 million, 1980-84	Military offset obligations of $2 million or more during fulfilled, 1980-84
Metal forgings and stampings (346)		X		X
Ordnance and accessories, except vehicles and guided missiles (348)	X	X	X	X
Miscellaneous fabricated metal products (349)		X	X	X
Engines and turbines (351)	X	X	X	X
Farm and garden machinery and equipment (352)				
Construction, mining, and materials-handling machinery and equipment (353)				X
Metalworking machinery and equipment (354)				X
Special industry machinery, except metalworking machinery (355)			X	X
General industrial machinery and equipment (356)				
Office, computing, and accounting machines (357)[1]			X	X
Refrigeration and service industry machinery (358)				
Miscellaneous machinery, except electrical (359)				
Electrical transmission and distribution equipment (361)				
Electrical industrial apparatus (362)	X	X	X	X
Electric lighting and wiring equipment (364)			X	
Radio and television receiving equipment, except communications types (365)				X

Table 4.--Products associated with countertrade sales agreements, countertrade obligations, or fulfillment of countertrade obligations, by types of occurrences, 1980-84 and 1985-2000--Continued

Product description (3-digest SIC code)	Sales agreements with military offset obligations of less than $2 million, 1980-84	Sales agreements associated with military offset obligations of $2 million or more, 1980-84	Military offset obligations of more than $2 million, 1980-84	Military offset obligations of $2 million or more during fulfilled, 1980-84
Communications equipment (366)	X	X	X	X
Electronic components and accessories (367)	X	X	X	X
Miscellaneous electrical machinery, equipment, and supplies (369)				X
Motor vehicles and motor-vehicle equipment (371)		X	X	X
Aircraft and parts (372)	X	X	X	X
Ship and boat building and repairing (373)				X
Railroad equipment (374)				
Motorcycles, bicycles, and parts (375)				
Guided missiles and space vehicles and parts (376)	X	X	X	X
Miscellaneous transportation equipment (379)	X	X		X
Engineering, laboratory, scientific, and research instruments and associated equipment (381)				X
Measuring and controlling instruments (382)		X		X
Optical instruments and lenses (383)	X		X	X
Surgical, medical, and dental instruments and supplies (384)				X
Ophthalmic goods (385)	X			X
Photographic equipment and supplies (386)	X			
Jewelry, silverware, and plated ware (391)				X
Toys and amusement, sporting and athletic goods (394)				

Table 4 .--Products associated with countertrade sales agreements, countertrade obligations, or fulfillment of countertrade obligations, by types of occurrences, 1980-84 and 1985-2000--Continued

Product description (3-digest SIC code)	Sales agreements with military offset obligations of less than $2 million, 1980-84	Sales agreements associated with military offset obligations of $2 million or more, 1980-84	Military offset obligations of more than $2 million, 1980-84	Military offset obligations of $2 million or more during fulfilled, 1980-84
Miscellaneous manufacturing industries (399)			X	X
Deep sea foreign transportation (441)				
Air transportation, certified carriers (451)			X	X
Fixed facilities and services related to air transportation (458)				X
Arrangement of transportation (472)				
Communications services, not elsewhere classified (489)			X	
Steam supply (496)				
Motor vehicles and automotive parts and supplies (501)				
Furniture and home furnishings (502)				
Metals and minerals, except petroleum (505)				X
Electrical goods (506)				X
Machinery, equipment, and supplies; chemicals and allied products (508, 516)			X	X
Miscellaneous durable goods (509)			X	X
Paper and paper products (511)				
Apparel, piece goods, and notions (513)				
Groceries and related products (514)				
Farm products, raw materials (515)				
Chemicals and allied products (516)				X

Table 4.--Products associated with countertrade sales agreements, countertrade obligations, or fulfillment of countertrade obligations, by types of occurrences, 1980-84 and 1985-2000--Continued

Product description (3-digest SIC code)	Sales agreements with military offset obligations of less than $2 million, 1980-84	Sales agreements associated with military offset obligations of $2 million or more, 1980-84	Military offset obligations of more than $2 million, 1980-84	Military offset obligations of $2 million or more during fulfilled, 1980-84
Petroleum and petroleum products (517)				X
Beer, wine, and distilled alcoholic beverages (518)				
Miscellaneous nondurable goods (519)			X	X
Miscellaneous investment (679)				
Hotels, motels, and tourist courts (701)			X	X
Miscellaneous personnel services (729)			X	
Computer and data processing services (737)	X	X	X	X
Miscellaneous business services (739)			X	X
Automotive repair shops (753)				
Automotive services (754)				
Electrical repair shops (762)				X
Miscellaneous repair shops and related services (769)			X	X
Medical and dental laboratories (807)			X	X
Health and allied services not elsewhere classified (809)				
Job training and vocational rehabilitation services (833)				X
Engineering, architectural, and surveying services (891)			X	X
Accounting, auditing, and bookkeeping services (893)				
Services, not elsewhere classified (899)			X	X

Table 5. —Number of countries that are new or enhanced sources of non-defense-related goods and services, by 3-digit SIC codes, 1980-84

Product or service SIC code	Number of countries
Miscellaneous special trade contractors (179)	1
Miscellaneous wood products (249)	1
Office furniture (252)	1
Soap, detergents, and cleaning preparations, perfumes, cosmetics, and other toilet preparations (284)	1
Miscellaneous plastics products (307)	1
Iron and steel foundries (332)	1
Miscellaneous fabricated metals (349)	3
Engines and turbines (351)	2
Metalworking machinery and equipment (354)	2
Communications equipment (366)	1
Electronic components and accessories (367)	7
Aircraft and parts (372)	3
Photographic equipment and supplies (386)	1
Miscellaneous manufacturing industries (399)	1
Fixed facilities and services related to air transportation (458)	1
Electric goods (506)	1
Machinery, equipment, and supplies (508)	3
Computer and data processing services (737)	2
Engineering, architectural, and surveying services (891)	1
Total	34

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Table 6.—Number of countries that are new or enhanced sources of defense-related goods and services, by 3-digit SIC codes, 1980-84

Product or service SIC code	Number of countries
Iron and steel foundries (332)	1
Rolling, drawing, and extruding of nonferrous metals (335)	1
Fabricated structural metal products (344)	3
Ordnance and accessories, except vehicles and guided missiles (348)	3
Miscellaneous fabricated metal products (349)	2
Engines and turbines (351)	8
Communication Equipment (366)	3
Electronic components and accessories (367)	8
Aircraft and parts (372)	8
Guided missiles and space vehicles and parts (376)	2
Optical instruments and lenses (383)	1
Total	40

Source: Compiled from data submitted in response to questionnaires of the U.S. International Trade Commission.

Mr. DINGELL. Dr. Stern, we thank you for a helpful summary of activities in this area.

Mr. Conahan, we will make a copy of your prepared remarks a part of the record. If you would like to highlight some of your principal concerns, please proceed.

TESTIMONY OF FRANK C. CONAHAN

Mr. CONAHAN. Thank you, sir. I would like to focus my remarks on three main points.

First, offset arrangements are not new. They are and are likely to continue to be facts of life in international trade, both in the military and much larger civilian trade sectors.

In our 1984 report we stated demands for offsets on weapon sales would increase. What we learned since then confirms our view.

Second, I would like to expand on the chairman's opening comments and discuss how certain national interests may be affected when a U.S. firm makes an offset commitment to a foreign government as a condition for the sale of U.S. defense articles.

In our earlier reports we found that no single agency comprehensively monitors offset activities and that no mechanism exists for incorporating the views of all key U.S. Government agencies and private industry in major offset decisions.

The situation remains much the same today although some steps have been taken to increase knowledge of these activities.

Third, I want to focus specifically on foreign buyers requiring offsets in cases where U.S. credit financing or in some cases grant financing is used to purchase defense systems. In effect, this could amount to a double benefit to the foreign buyer.

Concerning our first point, DOD has for decades engaged coproduction and other types of defense industrial cooperation programs to: One, enhance the national security of friendly countries; two, promote equipment standardization and interoperability among allies; and three, reduce redundant research and development. Coproduction arrangements can vary. In one type of coproduction program, the U.S. supplier shares production and sales of the end items with the participating countries. For example, one of the largest coproduction programs, which was mentioned in the opening statement concerns the F-16 arrangements with our European allies. Offsets in that case included the European countries producing 10 percent of the value of the initial U.S. aircraft buy, 15 percent of the value of all third country buys and 40 percent of the value of the European countries' buys.

Another type of coproduction program involves licensing the production of components in end items only for the purchasing countries own defense forces consumption. An example of this form is the F-15 venture with Japan which you, Mr. Chairman, mentioned earlier.

In the past coproduction or licensing of high technology items was largely confined to the industrialized nations. Less developed countries coproduced items at the lower end of the technology scale such as M-16 rifle by Singapore, South Korea, and the Philippines. Increasing demands are arising from developing countries for coproduction or licensed production of higher technology items such as coproduction of the F-16, with Turkey, Israel, and South Korea.

The concern is that these countries are developing defense industries which may later compete with U.S. defense industries. Many people in and out of Government are concerned that this aspect is not fully considered in coproduction decisions.

The seemingly increasing popularity of indirect offsets is causing additional concern. Indirect offsets involve the direct purchasing and/or marketing of the buyer's civilian or defense goods—which are unrelated to the military equipment being purchased.

According to a variety of sources, U.S. defense contractors have either bought or marketed in the United States under indirect offset obligations such products as office furniture and equipment, textile, products, cosmetics, radio and television receiving equipment, chemicals, and aircraft parts.

Indirect offset obligations are not limited, however, to commodities. U.S. defense contactors have agreed to promote tourism and set up manufacturing concerns in buyer countries, sometimes valued at hundreds of millions of dollars.

The concern here is that other industries may be adversely affected by the marketing strategies of defense contractors. For example, when buying U.S. aircraft in the late 1970's and the early 1980's, in addition to licensed coproduction, Canada required indirect offsets. In the sale of the F-18 the offset commitments totaled more than 100 percent of the sales value.

Mr. DINGELL. More than 100 percent?

Mr. CONAHAN. More than 100 percent, Mr. Chairman.

Many countries have policies or legislation seeking or requiring offsets on military purchases. Also, to enforce their policies, some countries currently incorporate penalty clauses in contracts with U.S. companies in the event that their offset commitments are not met.

Let me turn to the Government's role in this. While buyer nations have specific policies regarding offsets, the United States, a predominant supplier of military hardware, lacks a comprehensive approach to managing offsets.

There is no mechanism for assuring that views of the Department of Commerce and the Treasury and the Office of the United States Trade Representative are considered when a U.S. firm makes an offset commitment. In DOD's view, offsets are generally the responsibility of the contractor. DOD, however, is heavily involved in negotiating government-to-government coproduction agreements which may often also be a condition of the sale. Opinions vary greatly as to the effects of these offsets, and, I think, that in your opening statement you covered those pretty well; so I don't think I need to say much more about them right now.

However, I would make reference to our 1982 report wherein we pointed out that Japan had used technology and manufacturing know-how gained in military coproduction to enhance its civil aircraft industry. When Japan was producing the F-15 aircraft the Government of Japan was also assisting in the development of its civil aircraft industry.

Although performance requirements for military and civilian aircraft differ, development and manufacturing techniques are closely related and technological spinoffs can be anticipated. And, in connection with that coproduction project, Mr. Chairman, we transferred leading engine technology to Japan in avionics, instrumentation, propulsion and a number of those items.

Mr. DINGELL. Did we set the Japanese up in the aerospace industry?

Mr. CONAHAN. We certainly contributed, sir.

In that connection, Japan is currently participating with Boeing in producing the 767 commercial aircraft. In our 1982 report we concluded that United States had not devoted adequate attention to the economic implications of military coproduction.

One of the major stumbling blocks to assessing the potential impacts of offset arrangements has been the dearth of information on the nature and scope of these activities. We will study the information presented by Dr. Stern this morning and we look forward to the final ITC report and the OMB report.

Both studies we think should make major contributions in this area. We believe, however, that we need to put in place a continuing mechanism to develop this kind of information so that all entities who should have a voice in this, both within the Government and outside of the Government, will have a data base from which to work.

I shall conclude with some brief comments concerning offsets involving U.S. financing. My last concern which we believe warrants additional attention involves allowing offsets in transactions which are financed with U.S. Government assistance. Again, in our 1984 report on offsets we took the position that offsets should generally not be used when foreign military sales credits are involved.

Defense Security Assistance Agency officials told us that since June of 1984, FMS credits had not been used to finance mandatory direct offsets—with the exception of Israel. DOD, however, allows credits to be used in other ways to finance foreign production.

Turkey's coproduction of the F-16 aircraft, which you referred to in your opening statement, Mr. Chairman, is a good illustration of how these policies work in practice. Turkey, which received $700 million in grants and credits in fiscal year 1985, expects to coproduce portions of 152 of the 160 F-16's it is purchasing with both FMS credits and its own funds.

However, Turkey does not yet have the capability to produce its share of the aircraft. Turkey may use FMS credits for any tooling, licenses, and technical data packages of U.S. origin.

In other words, credits can be used to help establish its production capability. Furthermore, as part of the offset package, the U.S. contractor has agreed to invest in the Turkish aerospace industry.

One final example, Mr. Chairman, demonstrates a rather unique effect of neogtiated offset agreements. As I discussed earlier, the F-16 arrangment with the four European countries involves their coproducing 15 percent of the value of all third-country buys.

As things turned out, the F-16 has been sold to a number of countries which received and are receiving U.S. financing assistance, and in the case of Israel and Egypt, forgiven loans. Thus, even though the United States is subsidizing the sale and in some cases giving aircraft away, the United States is still obligated to give 15 percent of the production to the European nations.

To us this suggests the need for careful consideration of terms and future coproduction and offsetting agreements. That concludes my summary, Mr. Chairman.

Mr. DINGELL. Without objection, Mr. Conahan, your statement will appear in the record.

[Testimony resumes on p. 338.]

[The prepared statement of Mr. Conahan follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
Thursday, October 10, 1985

STATEMENT OF
FRANK C. CONAHAN
U.S. GENERAL ACCOUNTING OFFICE
BEFORE THE
COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
HOUSE OF REPRESENTATIVES
ON
FOREIGN MILITARY SALES AND OFFSETS

Mr. Chairman, Members of the Subcommittees:

I am pleased to be here today to discuss offsets associated with U.S. overseas sales of military equipment. Over the past few years, we have issued several reports dealing with offsets, and coproduction programs. In these reports we raised questions about the impact of these arrangements, and the U.S. policy for coping with foreign country demands for increasingly large offsets.

Today I would like to focus my remarks on three main points.

- First, offsets arrangements are not new. They are, and will likely continue to be, facts of life in international trade--both in the military and much larger civilian trade sectors. In a 1984 report, we stated that demands for offsets on weapons sales would increase. What we have learned since then confirms our view.

- Secondly, I would like to discuss how certain national interests may be affected when a U.S. firm makes an offset commitment to a foreign government as a condition for the sale of U.S. defense articles. In our earlier reports we found that no single agency comprehensively monitors offset activities, and that no mechanism exists for incorporating the views of all key U.S. government agencies and private industry in major offset decisions. The situation remains much the same today, although some steps have been taken to increase knowledge of these activities.
- Thirdly, I want to focus specifically on foreign buyers requiring offsets in cases where U.S. credit financing--or in some cases grant financing--is used to purchase defense systems. In effect, this could amount to a double benefit to the foreign buyer.

But before we get into these points, some background and definitions are in order.

DEFINING OFFSETS

Unfortunately, the concept of offsets lacks uniform definition, and a variety of terms are used by different government and business entities to describe the same phenomenon. Today, I will be using the term "offsets" to refer to trade arrangements made as conditions of foreign military sales. Essentially these are arrangements intended to reduce the impact of costly weapons purchases on the buyer's balance of payments, or to provide the buyer with other advantages.

Offsets can take many forms and are usually categorized as either direct--that is, related to the weapon system being bought--or indirect--related to other products or services. Coproduction and licensed production, which involve production of part or all of a weapon system in the purchasing country, are the major forms of direct offsets. Other forms of offsets include subcontracting in the buyer country, transferring technology, investing in the buyer country and/or purchasing and marketing goods and services unrelated to the weapon systems being acquired.

From industries' perspective, it is usually preferable to sell outright, with no obligations to share production or technology or to commit to make purchases from a buyer. Notwithstanding, U.S. contractors are willing to enter into offset agreements because they are considered necessary to compete for and win sales. Essentially, offsets are viewed as marketing tools to help gain sales which otherwise might be lost. In addition, DOD and State support certain coproduction or licensed production agreements because they foster NATO standardization and enhance national security interests.

From the buyer's perspective, offsets are very attractive. Offsets reduce the impact of very expensive acquisitions on balance-of-payment positions, provide valuable technology and manufacturing know-how, support domestic employment, and create or expand independent defense industries. With these advantages, buyers may overlook some drawbacks. For instance, coproduction is an inefficient use of defense resources, because it increases unit costs. As an example, even though Japan has limited its defense spending to one percent of its GNP, it has been willing to spend two to three times more to coproduce some defense items rather than buy them off the shelf.

U.S. EXPERIENCE

For decades, DOD has encouraged coproduction and other types of defense industrial cooperation programs to (1) enhance the national security of friendly countries, (2) promote equipment standardization and interoperability among allies, and (3) reduce redundant research and development. The hardware produced ranged from rifles, ammunition, and howitzers to tanks, ships, missiles, and aircraft.

Coproduction arrangements can vary. In one type of coproduction program, the U.S. supplier shares production and sales of the end items with the participating countries. For example, one of the largest coproduction programs--the purchase of the F-16 by Norway, Denmark, Belgium, and the Netherlands, known as the European Participating Governments (EPG)--involved a contract worth $2.8 billion (January 1975 dollars). The intention was to facilitate NATO rationalization, standardization, and interoperability by inducing the selection of the F-16 as a replacement fighter aircraft for the NATO consortium countries. Offsets included the EPG coproducing 10 percent of the value of the initial U.S. aircraft buy, 15 percent of the value of all third-country buys, and 40 percent of the value of the EPG buys.

Another type of coproduction program involves licensing the production of components of the end-item only for the purchasing country's own defense forces' consumption. An example of this form is the F-15 venture with Japan.

According to DSAA, some recent examples of coproduction sponsored or licensing approved by the U.S. government include:

PATRIOT Air Defense System with Japan, Germany, and The Netherlands;

AIM-9L missile with Japan,

F-18 aircraft with Australia, Spain, and Canada.

In the past, coproduction or licensing of high technology items was largely confined to the industrialized nations. Less developed countries coproduced items at the lower end of the technology scale, such as the M-16 rifle by Singapore, South Korea, and the Philippines. Increasing demands are arising from developing countries for coproduction or licensed production of higher technology items, such as coproduction of the F-16 with Turkey, Israel, and South Korea. The concern is that these countries are developing defense industries which may later compete with U.S. defense industries. Many people in and out of government are concerned that this aspect is not fully considered in coproduction decisions.

The seemingly increasing popularity of indirect offsets is causing additional concern. Indirect offsets involve the direct purchasing and/or marketing of the buyer's civilian or defense goods--which are unrelated to the military equipment being purchased. According to a variety of sources, U.S. defense contractors have either bought or marketed in the United States under indirect offset obligations such products as office furniture and equipment, textile products, cosmetics, radio and television receiving equipment, chemicals, and aircraft parts. Indirect offset obligations are not limited to "moving" commodities. U.S. defense contractors have agreed to promote tourism and set up manufacturing concerns in buyer countries sometimes valued at hundreds of millions of dollars per defense sale. The concern here is that other industries may be adversely affected by the marketing strategies of defense contractors.

For example, when buying U.S. aircraft in the late 1970s and the early 1980s, in addition to licensed coproduction, Canada required indirect offsets including U.S. contractor purchases of Canadian-built components for other planes and other industrial benefits to Canada. In addition, the U.S. contractors agreed to promote travel and tourism in Canada. In the sale of one aircraft, the F-18, the offset commitments totalled more than 100 percent of the sales value.

In another example, Saudi Arabia's $3.7 billion Peace Shield air defense and communications project involves several offset programs resulting in U.S. technology transfers. Of the $3.7 billion, some $1.2 billion is to be tied to offset obligations fulfilled by a Boeing-led consortium, largely in the area of direct investment in viable manufacturing concerns in Saudi Arabia, preferably high-technology related.

One additional example--in the sale of the F-18 to Spain--McDonnell Douglas agreed to market Spanish exports, promote tourism, and provide for other indirect offsets, totalling about $1.3 billion.

Many countries have policies or legislation seeking or requiring offsets on military purchases. For example, South Korean policy requires a minimum of 50 percent offsets for imports over $1 million with a minimum of 20 percent being direct offsets with technology transfer. Australia has an offset requirement policy of at least 30 percent and is considering increasing the policy to 40 percent. The Israeli government has a policy of requesting U.S. suppliers to offset or "buy back" from Israel goods or services. To enforce their policies, some countries currently incorporate penalty clauses in contracts with U.S. companies in the event that their offset commitments are not met. Also being considered is the idea that companies which have not fulfilled previous offset agreements will not be eligible for new contracts.

U.S. GOVERNMENT ROLE

While "buyer" nations have specific policies regarding offsets, the United States as a predominant seller of military hardware lacks a comprehensive approach to managing offsets. The government takes no active role in administering offset transactions, and no agency monitors offset activity. Furthermore, there is no mechanism for assuring that views of the Departments of Commerce and the Treasury and the Office of

U.S. Trade Representative are considered when a U.S. firm makes an offset commitment. For DOD's part, since 1978 its stated policy has been not to become involved in negotiating or guaranteeing indirect offset agreements. In DOD's stated view, offsets are generally the responsibility of the contractor. DOD, however, is heavily involved in negotiating government-to-government coproduction agreements, which may often be a condition of the sale.

Opinions vary greatly as to the effects of offsets. Supporters of offsets claim that such arrangements can benefit U.S. national defense interests through commonality of weapon systems, create closer ties with friendly countries, lower unit costs, and generate or retain U.S. jobs (because without offsets, sales otherwise would not be made). On the other hand, critics maintain that foreign government-mandated offset agreements can erode the subcontractor industrial base, develop future competitors, create unemployment in and competition for unrelated industries, and subsidize inefficient foreign industry.

In a 1982 report, we pointed out that Japan used technology and manufacturing know-how gained in military coproduction to enhance its civil aircraft industry. When Japan was coproducing the F-15 aircraft, the Government of Japan was also assisting in the development of its civil aircraft industry. Although performance requirements for military and civil aircraft differ, development and manufacturing techniques are closely related and technological spinoffs can be anticipated. For example, composites, avionics, instrumentation, and propulsion technologies transferred through the F-15 program could be applied to civil aircraft production. Many U.S. government and industry representatives were concerned that Japan could use this technology to help become a competitor in the world civil aircraft market. Japan is currently participating with Boeing in producing the 767 commercial aircraft, and should be considered a likely participant in the next generation commercial transport.

In our 1982 report, we concluded that the United States had not devoted adequate attention to the economic implications of military coproduction. We recommended that Defense and State coordinate with the Departments of Commerce, the Treasury, Labor, and the Office of the U.S. Trade Representative when considering coproduction requests involving high technology items. The other agencies generally agreed with the need for more interagency coordination, but DOD stated that the present system was working adequately.

One of the major stumbling blocks to assessing the potential impacts of offset arrangements is the dearth of information on the nature and scope of these activities. DOD's 1983 coproduction study estimates that about $30 billion in potential arms sales during the period 1983-88 would involve offsets.

In our April 1984 report we had pointed out that while several U.S. government agencies had been studying the effects of offsets on various national interests, their efforts remained insufficiently coordinated. Since that time, two major U.S. government efforts have been undertaken to determine how extensive offset arrangements are and to ascertain their potential impact on the United States. First, in 1984, the Congress passed legislation (section 309 of the Defense Production Act) requiring the President to report on the impact of offsets on U.S. defense preparedness, industrial competitiveness, employment, and trade. Although the law requires that this report be completed by October 17, we understand an extension of time has been requested. In addition, the International Trade Commission (ITC) has also completed its own assessment to determine the extensiveness of offsets or countertrade in both military and civilian sales. The ITC study is due out soon.

Both studies may make major contributions to the understanding of this complex subject. But, in our opinion, they are not substitutes for a continuing mechanism to collect and analyze data. Without a valid and comprehensive data base, it would be difficult to determine the impact of offsets, and it would limit the ability of the Departments of Commerce and the Treasury and the U.S. Trade Representative to participate effectively in important offset decisions.

OFFSETS INVOLVING U.S. FINANCING

One last concern which we believe warrants additional attention involves allowing offsets in transactions which are financed with U.S. government assistance. Some of the countries now requesting direct and indirect offsets--such as Egypt, Greece, Indonesia, Israel, South Korea, Spain, Pakistan, Turkey--are also receiving financing assistance. In our 1984 report on offsets we took the position that offsets should generally not be used when Foreign Military Sales (FMS) credits are involved.

DOD's policy is that FMS credits may not be used to directly finance coproduction or licensed production as a condition of sale. Thus, use of FMS credits to pay for the components produced in the foreign purchasing country is not normally permitted. DOD will, however, permit credits to be used for the portion of the end item that is produced in the United States. Regarding indirect offsets, DOD's stated policy is to discourage credit financing for purchases containing indirect offset provisions. DOD, however, is not a party to indirect offset arrangements and these are difficult to control.

Defense Security Assistance Agency (DSAA) officials told us that, since June 1984, FMS credits had not been used to finance mandatory direct offsets--with the exception of Israel. DOD, however, allows credits to be used in other ways to finance foreign production. For example, under a defense industrial cooperative agreement, Turkey will coproduce helicopters using credits. Also credits may be used to pay for items which include up to 49 percent foreign content, thus allowing contractors to subcontract overseas. Furthermore, credits may be used to finance U.S. origin tooling, technical data packages, and licenses. We have not determined the extent of these practices or the extent to which they are being required as a condition of a sale.

Turkey's coproduction of the F-16 aircraft is a good illustration of how these policies work in practice. Turkey, which received $700 million in grants and credits in FY 1985, expects to coproduce portions of 152 of the 160 F-16s it is purchasing with both FMS credits and its own funds. The credits can be spent on the U.S.-produced portions of the aircraft, and Turkey will use its own cash to pay for items produced in Turkey. However, Turkey does not yet have the capability to produce its share of the aircraft. Turkey may use FMS credits for any tooling, licenses, and technical data packages of U.S. origin--in other words, credits can be used to help establish a production capability. Furthermore, as part of the offset package, the U.S. contractor has agreed to invest in the Turkish aerospace industry.

Over the past several years, Israel has had the bulk of its loan repayments waived and has also been active in obtaining offsets--both direct and indirect. For example, in FY 1985 the United States permitted up to $200 million of FMS credits to go toward direct offsets through subcontracting in Israel. Israel also is coproducing about $300 million in components in its second buy of F-16s. Furthermore, we were told by DSAA that most Israeli purchases receive a 10 to 15 percent indirect offset with a penalty clause for non-performance.

A good example of use of indirect offsets by a credit recipient involves the potential sale of F-16s to Greece, which is currently being considered by the Administration. Greece is seeking indirect offsets for this purchase. Industry proposals for meeting this requirement include investments in problem industries, technical assistance, aid in expanding Greece's aerospace sector, technology transfers, export sales of Greek products targeted by the Government of Greece, and tourism promotion.

One final example demonstrates a rather unique effect of negotiated offset agreements. As I discussed earlier, the F-16 arrangement with the four European countries involves their coproducing 15 percent of the value of all third-country buys. As things turned out, the F-16 has been sold to a number of countries which received U.S. financing assistance (and, in the case of Israel and Egypt, forgiven loans). Thus even though the United States is subsidizing the sale, and in some cases giving aircraft away, the United States is still obligated to give 15 percent of the production to the European nations. To us, this suggests the need for careful consideration of terms of future co-production and offset agreements.

This concludes my prepared remarks. I would be happy to answer any questions you might have.

Mr. **Dingell**.The Chair wants to commend you and Dr. Stern and the General Accounting Office and the International Trade Commission for your assistance today. It has been a very high order.

The Chair will inquire, Mr. DeMarines, do you have any comments you would like to add to the statements made so far?

Mr. **DeMarines**. No; I don't.

Mr. **Dingell**. Ms. McCabe?

Ms. **McCabe**. No.

Mr. **Dingell**. Ms. D'Agostino?

Ms. **D'Agostino**. No.

Mr. **Dingell**. The Chair thanks you for your keen participation in this, and we thank you for your assistance.

The Chair will recognize my colleagues for questions for 5 minutes. The Chair recognizes the gentleman from Oregon first.

Mr. **Wyden**. Are you satisfied that the data you have collected is adequate for policymakers to evaluate the impact of offsets associated with American armed sales abroad?

Ms. **Stern**. I believe that it is a very full response. We sent surveys out to 154 different contractors, and we looked at 119 different contracts. It is a very universal survey, and I think it is very full. I think that policymakers should feel equipped to make policy now on how to deal with this practice.

Mr. **Wyden**. So you did a survey of defense contractors around the country?

Ms. **Stern**. That is right.

Mr. **Wyden**. You feel it accurately portrays now, it doesn't understate, the problem?

Ms. **Stern**. I believe that if you look at the data for 1980 through 1984, you can make your own analysis. We did not analyze the data in any detailed form. We had initiated a study on the overall practice of countertrade, and when we went for clearance to the OMB to send out our questionnaires, we were asked, in effect, to do the OMB's work that had been required by Congress to survey the military contractors. So we did not—we have delivered that information those statistics, which I have summarized for you today on the military aspect, and leave it to the executive branch, who have been charged by Congress to do this study of the practices, to draw their conclusions.

Mr. **Wyden**. My own feeling is we don't know at all what is going on, that it clearly could be larger than we think, and we are going to evaluate the data that you are talking about very carefully as well.

Would you describe the magnitude of offsets as significant or fairly significant?

Ms. **Stern**. I think it is definitely significant. No question about it. On the question of understatement, there is—if you just read the data and don't do any analysis or projections, you may be misled. But I urge you not to be, because while there may have been a dip for 1982 in some of the reporting, that does not necessarily reflect a trend. On the contrary, we do believe there does seem to be an increase in trend in which obligations—offset obligations have been required.

Mr. **Wyden**. There have been some wild fluctuations as well. You mentioned in your statement the flow went from 7 billion to 10 billion. But it doesn't explain offsets dropping from 94 percent to 7 percent.

Ms. **Stern**. Well, I think that there is—there are lag times involved. I think we have seen severe annual fluctuations as far as the reported military sales. I think that figure from—the high of 1980 to the low of 1982, it happens to be serendipity, I think there were just more sales made those years.

But as far as the actual trends of the required obligations that are to the sales ratio, I think that while there may have been a dip for 1982, that is another measure, there is a trend of increasing—an increase there.

Mr. **Wyden**. I am going to move along, and I know my colleagues want to explore this as well. But I am not sure that change from 94 percent to 7 percent is just serendipity.

Ms. **Stern**. Mr. DeMarines has done a rerun on a number of these figures in order to assure us they reflect the respondents' reporting. Of course, any good study is subject to the cooperation of the respondents, and we have to deal with the numbers that are given to us.

I would like to give Mr. DeMarines an opportunity to comment.

Mr. **DeMarines**. The figure you are talking about, the 1982 data, which dips to $742 million, are sales that are associated with military offsets, and it happens to be an accurate portrayal of what the respondents told us, and we have verified that with the respondents—in fact, it is just a quirk in the sales contract associated with offsets in that particular year. It does not represent a trend.

Mr. **Wyden**. I know my time has expired, one other quick question. What concerns prompted your study on military offsets?

Ms. **Stern**. As I said, we initiated a study on the overall question of barter and countertrade, and I must say that this was something which came from within-house at the International Trade Commission, and I have to give credit to my colleague, Ron DeMarines, who has for years been interested in this question. We did the first study ever, made it public several years ago, doing the literature research, describing basically everything that was on the books, if you will, on the subject.

And then this study, which really gets into data and actually surveys the entire U.S. economy, is a follow-on on that. We feel it is a very serious practice, a very important practice, and certainly in the military area one that is increasing a great deal. I might say about 75 percent of the countertrade practices that are ongoing are practiced in military sales. The actual study of the data of the military contractors was forced by this coincidence that OMB had been asked to do a study by surveying the military contractors.

Mr. **Dingell**. The time of the gentleman has expired. The gentleman from Ohio, Mr. Luken.

Mr. **Luken**. Ms. Stern, did you do anything in compiling this survey but send out the questionnaires and compile the results? Did you do any interviewing?

Ms. **Stern**. I would like Mr. DeMarines to give you background on that.

Mr. **DeMarines**. Yes, we did interview a number of respondents. We verified all the responses. And our survey——

Mr. **Luken**. You interviewed them to verify the response?

Mr. **DeMarines**. We interviewed to verify and to clarify, as well, any of their responses.

Mr. **Luken**. I don't know what clarify——

Mr. **Dingell**. Will the gentleman yield?

Mr. **Luken**. If I get another minute.

Mr. **Dingell**. Did you get any documents in connection with your verification process?

Mr. **DeMarines**. No, we did not.

Mr. **Dingell**. How do you call that a verification?

Mr. **DeMarines**. The respondents reported in a questionnaire, a questionnaire whose response is mandatory, and we have to rely on that for our data base. We have no access to their individual corporate records other than through the use of the questionnaire.

Mr. **Dingell**. So you can tell us that you got a response to the questionnaire, but you can't tell us that response was, in fact, adequate or truthful.

Mr. **DeMarines**. I assume that it is, but I can't tell you definitely.

Mr. **Dingell**. Trust is one of the great virtues. Suspicion and a certain healthy paranoia where you are dealing with great public questions is always a virtue which is not enumerated in the Bible. I am curious. Did you have any verification that would comfort a more suspicious soul like me?

Mr. **DeMarines**. We did look at the published reports, the press reports, and matched them with our responses.

Mr. **Dingell**. But you never looked at the books of the corporations?

Mr. **DeMarines**. No, we did not have access to them.

Mr. **Dingell**. Am I unfair in assuming some of these press reports were generated by the companies and the Department of Defense?

Mr. **DeMarines**. They were usually taken out of independent press trade reports.

Mr. **Dingell**. Which were generated from the Department of Defense and the companies in question?

Mr. **DeMarines**. Yes. With interviews of those corporations.

Mr. **Dingell**. I hardly find that a comforting verification. The Chair will not take any more of the gentleman's time.

Mr. **Luken**. Dr. Stern, what stands out in stark contrast to your testimony, and Dr. Conahan, as to the motivation and the results of this offset, what the GAO says is that there is no mechanism that exists for incorporating the views of all key U.S. Government agencies and private industries and major offset decisions, and he points out many detrimental effects. You don't point out any of those detrimental effects.

As a matter of fact, your summary here, you say the Commission study found several interesting consequences, then you rattle off a whole lot of things on page 7 that would seem to be—it is fantasy land as far as I can see. It is as if these contractors were actually voluntarily engaging in this offset. Is that what you are suggesting, they want to engage in barter instead of cash?

Ms. **Stern**. No, I am not suggesting anything. My purpose here was to summarize the responses to the survey.

Mr. **Luken**. Are these people under the gun? Why did they respond in such a ridiculous way?

Ms. **Stern**. I do believe——

Mr. **Luken**. It is so contrary to what the GAO reports, and their observations seem to be sensible.

Ms. **Stern**. First off, I do not believe that my viewpoint is contrary to GAO. I don't think that we found any indication to contradict the GAO. There was some sort of interagency views and coordinated policy, looking into this question.

Mr. **Luken**. I hope they go further than looking into it. What the GAO is suggesting and what the contractors have told me, they said they would like to have a governmental policy, that they are being forced into this offset business, and they would like to have some governmental policy that will relieve them of this obligation. But you don't suggest anything like that.

Ms. **Stern**. Congressman Luken, my position is head of the International Trade Commission. We are not part of the executive branch. We are separate from the executive branch, and that is the reason why both the Congress and the executive branch call on us to do these kinds of surveys, as well as to deal with unfair trade practices and look into the question of whether industries are being injured by certain practices.

Mr. **Luken**. You come up with opposite views from the GAO. The net effect of this is to put a euphoric interpretation of your statement, this offset isn't hurting our trade, that we are getting new technology. As a matter of fact, we are exploiting technology, and we are giving the opportunities to the beneficiaries of our largess to use that technology and to compete with us. Isn't that what is happening, Dr. Stern? Isn't it?

Ms. **Stern**. The down side——

Mr. **Luken**. Is it or isn't it? Can you answer that?

Ms. **Stern**. What we found—and again I am limited by the data that I have before me. I have not done the kind of analysis which would require these policy considerations that you are asking. I think they are important questions that should be asked. I, as the head of the agency, can only tell you what we found the down sides were, that businesses were creating competition for themselves, potential competition for themselves, both through the transfer of technology overseas, as well as through the creation of foreign sources of new products and new services.

Mr. **Luken**. Are you aware U.S. taxpayers subsidize many of these purchases——

Ms. **Stern**. Yes, I am. I have been a long-time observer of the military sales program. In fact, I was the——

Mr. **Luken**. Then if we are subsidizing much of it, what is the benefit of bartering goods away?

Ms. **Stern**. I think it is a superb question that should be asked of those responsible for the policy, and that is the executive branch.

Mr. **Luken**. Can't we ask you?

Ms. **Stern**. What I am saying, Mr. Luken, is I think that these questions are important, I would drive in the same direction you are driving, but as far as the competence of the International

Trade Commission on answering those questions, we did only a data survey.

Mr. **Luken**. Would you answer one question? When new sources emerge as a result of technology transfer in these instances, doesn't that mean we have given another country the means to compete against us?

Ms. **Stern**. Absolutely. No question about it.

Mr. **Wyden** [presiding]. The gentleman from Texas is recognized.

Mr. **Bryant**. Dr. Stern, you answered this one, but what did you say prompted your study on military offsets?

Ms. **Stern**. We were doing a study, we had self-initiated a study on the overall question of barter and countertrade practices.

When we went to the OMB to get the clearance to send out our questionnaires to the various companies, the OMB had coincidentally been charged by the Vento amendment, as I understand it, to do an interagency study of these questions which Congressman Luken has put to me.

In order to avoid repetition in going to the potential respondents, the OMB, in effect, said, "You, the ITC, do the survey of the military subcontractors for us." We have now turned over the survey results to the OMB who I am told are supposed to be coordinating an executive branch study on these policy questions in response to the Congress under the Vento amendment.

Mr. **Bryant**. Their data base will be the same as yours since you provided it.

Ms. **Stern**. Absolutely.

Mr. **Bryant**. You have to educate us briefly. Why did your independent agency have to ask OMB people for permission to contact these people?

Ms. **Stern**. It is a very good question, and we have been increasingly concerned about this, because one of our questionnaires didn't go out this past summer on the semiconductor industry.

Mr. **Bryant**. What does that mean, didn't go out?

Ms. **Stern**. The OMB didn't give us clearance to send the questionnaire out. We are an independent agency and have never had difficulties getting clearances from OMB heretofore. We have had increasing difficulties, and I am concerned about our independence in this area.

Mr. **Bryant**. Why did it even occur to you to contact the OMB to ask permission?

Ms. **Stern**. It is their reading of the Paperwork Reduction Act; they read the International Trade Commission to come under that rubric. We must send our questionnaires through the OMB for clearance before they are sent out in order to avoid questioning companies excessively, to reduce paperwork.

Mr. **Bryant**. They get to read the content and see if you have the right to mail a particular question?

Ms. **Stern**. So far, we have been successful in getting our questionnaires out.

Mr. **Bryant**. You didn't answer my question. That is effectively, they decide whether you can send it or not based on the content?

Ms. **Stern**. They say it is based on the question of whether it is administratively burdensome.

Mr. **Bryant**. Based on the content.

Ms. STERN. Absolutely.

Mr. BRYANT. Have they prohibited you from sending others out?

Ms. STERN. They prohibited us from sending out the semiconductor questionnaire. We rarely initiate studies, but it just so happens we are talking about two of them. We needed a data base to know what was going on, and that questionnaire was never sent out.

Mr. BRYANT. What else have you attempted to send out in your industry, whether related to this inquiry or not, they have prevented you from sending out?

Ms. STERN. That was precedent setting.

Mr. BRYANT. How long does it take you to get clearance to send out things?

Ms. STERN. Sixty days. They are supposed to after 60 days send the things out. They sat on it for 60 days, and it didn't go out nor did OMB get back to us and say can you change the questionnaires so it is a little less burdensome? We didn't get any kind of request to do any kind of changes or alterations.

Mr. BRYANT. Did they dictate the questionnaire you used on what we are discussing today, on offsets?

Mr. DEMARINES. The ITC worked with the interagency group to develop the military side of the questionnaire. They had very little impact on the countertrade portion of the questionnaire.

Mr. BRYANT. But they did on the military.

Mr. DEMARINES. Yes. Because the data we were collecting was mainly for their purposes for the Vento amendment requirement.

Mr. BRYANT. Well, that is the data you are testifying about, right?

Mr. DEMARINES. That is right.

Mr. BRYANT. Let me ask you a question. I don't understand statutorily how this can be. You are an independent agency, I assume you are confirmed by the Senate, we vote on a budget for you——

Ms. STERN. Yes, it goes directly to you, not through the OMB.

Mr. BRYANT. By what statutory means do they impose themselves on anything you do? If you don't follow the guidelines they attempt to impose upon you, what happens?

Ms. STERN. It has never been tested. On the semiconductor thing——

Mr. BRYANT. You must have lawyers, though. What do your lawyers tell you? I don't understand——

Ms. STERN. We are in the middle of testing it right now on the semiconductor questionnaire. The question falls on whether we are "an independent agency" as defined by the law, and OMB is interpreting the law one way, we are interpreting it another way. We are interpreting that we are an independent agency. As I said, heretofore there has been, in effect, I suppose, a gentleman's agreement. We have not had this problem before.

Mr. BRYANT. I am interested in that, and I hope you will agree to submit answers in writing to the committee.

Ms. STERN. I would be happy to.

Mr. BRYANT. If I read table four of your chart correctly, you have listed approximately 60 product areas that have incurred obligations of more than $2 million because of military offsets. Is that a correct reading?

Ms. Stern. Yes, absolutely.

Mr. Bryant. These products include chemicals, metals, hardwares, engines, offset equipment—I am sorry, office equipment, communications equipment, motor vehicles and jewelry, just to name some of them. It is my understanding foreign governments are, in effect, bartering these items in return for U.S. military hardware. Is that correct?

Ms. Stern. I think that we have been—yes, yes. We have been careful about the use of barter, countertrade and so forth, that is why I was hesitating.

Mr. Bryant. Are textiles being imported into the United States to fulfill foreign military sales of set commitments?

Ms. Stern. Ron, do you know offhand? Footwear.

Mr. DeMarines. Yes, I think there are some instances of imports of textiles, but I can't verify that without looking directly at the questionnaire responses.

Ms. Stern. Let's say yes, and we will verify it.

Here, we have apparel—no—we have apparel listed, but don't have a check by it.

Mr. Bryant. Are shoes being imported into this country to pay for foreign military sales?

Ms. Stern. Shoes are being imported as part of an offset obligation.

Mr. Bryant. Your answer is that textiles are as well, is that correct?

Ms. Stern. Only because I trust Ron, because he thinks it was, and if it is wrong, we will get back to you right away. I think we have to go back and look at the actual responses.

Mr. Bryant. Do you know why these arrangements aren't better publicized when concerns are raised about protecting these industries?

Ms. Stern. I don't know. We do know that many of the offset obligations don't necessarily result in actual imports, though. The figures that you just referred to are actual imports. We do have the antidumping laws, by which if an industry in the United States feels that they have been injured by the importation of products which have come in which are sold here in this country at what is known as less than fair value, that they have been dumped, then they can come to the International Trade Commission for relief. The relief is granted in connection with the Department of Commerce which has to find there is an unfair act, and the relief would be in the form of a dumping duty, which would counteract that unfair practice.

Mr. Bryant. Have you had someone come before the ITC complaining of one of these unfair practices that reulted from a barter?

Ms. Stern. Not to my knowledge, and I have been there for 7 years. But I can go back and try to—you know, we have about 280 cases a year, so I could be wrong. I will verify that.

Mr. Wyden. Would the gentleman yield?

Mr. Bryant. Yes.

Mr. Wyden. Do you think the industries even know about their rights, as they don't have the knowledge this is going on?

Ms. Stern. Since, as I said, we have about 280 cases a year, we have an increasing caseload, I think people are increasingly aware of the impact of imports on them. It may necessarily be resulting from an offset arrangement, perhaps not. But regardless of how it comes in, if it is being dumped, they do have that recourse.

Mr. **Wyden**. They don't seem to know anything about offsets, and that is why I think the gentleman's question is a very important one. He asked one specifically about offsets, you said you had been there for 7 years and hadn't seen one.

Ms. **Stern**. That is correct.

Mr. **Wyden**. I appreciate the gentleman yielding.

Mr. **Bryant**. Our committee investigators, in talking to your staff, were told of the $3.6 billion in direct offset, $2.8 billion were unspecified. Is that correct?

Ms. **Stern**. That is correct

Mr. **Bryant**. Isn't it also true, since most of them are unspecified, we didn't determine many of the impacted industries?

Ms. **Stern**. That is absolutely correct.

Mr. **Bryant**. So the fact is 60 product areas identified in your report may only be the tip of the iceberg.

Ms. **Stern**. That is absolutely correct.

Mr. **Wyden**. The time of the gentleman has expired. Dr. Stern, you mentioned that the United States exported $47.8 billion in military goods between 1980 and 1984. Does this figure include products coproduced or licensed, produced overseas?

Ms. **Stern**. The 47.8 was sales, not exports. Is that——

Mr. **Wyden**. Yes, yes.

Ms. **Stern**. You are asking——

Mr. **Wyden**. Does it include coproduction and licensed, produced overseas?

Ms. **Stern**. Offset obligatons would possibly include coproduction and licensing overseas. Mr. DeMarines wants to either add or subtract from what I just said to you.

Mr. **DeMarines**. The $47 billion figure was the total face value of the export sales contract signed by U.S. defense contractors. Of the total value of sales contract signed—less than 50 percent of those had offset obligations.

Mr. **Wyden**. Does that include coproduction and licensed, produced overseas?

Mr. **DeMarines**. If you look at the obligations themselves, that is what the U.S. defense contractors are obliged to do in order to get the sale, that is a much smaller figure of $8.8 billion.

Mr. **Wyden**. Would it include 15 percent to the EPG Turkey sale?

Mr. **DeMarines**. It probably would, yes.

Mr. **Wyden**. Probably, again, is what this committee is so concerned about——

Mr. **DeMarines**. It would. Any linked arrangement as a result of a sale would be part of the offset, and the corporation would get credit for that.

Mr. **Wyden**. But it is not linked, at least in the question of the Turkey sale.

Mr. **DeMarines**. If it is part of the transaction, we consider it a linked transaction.

Mr. **Wyden**. Does your offset figure include sales that have been recorded where the offsets have not been definitized?

Ms. **Stern**. Yes. There is a lag time that then would result in several years later, we would actually see in that third measure the value of the offset obligations actually fulfilled.

Mr. **Wyden**. That is a key consideration for us, in our concern there is an under-estimation going on, is that there has been a lag time between the sale and when the offsets are actually definitized, and what we are concerned about is that could skew the data and underestimate the situation. Would you agree with that as a real possibility?

Ms. **Stern**. I think it is a real possibility. We still do not know what is going to result in products either coming in or obligations actually fulfilled because it may take up to 10 years for the obligation to be completed.

Mr. **Wyden**. Well, does this then explain how the report shows the offsets at a 7-percent level in 1982?

Ms. **Stern**. It is not an offset. That 7-percent figure refers to the—is it the first measure—it refers to the first measure, which is the total export value of sales agreements with which offset commitments are associated.

There are three different measures by which we measure this data, and they reflect different points along the way—first is when the agreement is made, then we measure what portion of the agreement is actually an obligation, and then the third measure was when the actual offset obligation is actually fulfilled.

Mr. **Wyden**. What were some of the largest defense sales in 1982?

Ms. **Stern**. Can we provide that in confidence?

Mr. **Wyden**. Yes. What we would like is the 10 largest defense sales so that we can analyze that and really try to assess the 7 percent.

Ms. **Stern**. Yes, we would be happy to.

Mr. **Wyden**. Mr. Conahan, I assume we can have the help of the GAO in analyzing the material that will be sent us by Dr. Stern?

Mr. **Conahan**. You can certainly count on that, sir.

Mr. **Wyden**. If we remove the 1982 figures, Dr. Stern, offset obligations rise to approximately 60 percent of U.S. military exports. Further, using the figure for 1982, the offsets increased by over $5 billion. Aren't these a little bit more realistic figures in terms of really appraising what is going on here?

Ms. **Stern**. I think so. I think that you can—because that 1983 dip can mislead you into thinking perhaps there has been a declining trend. You can make adjustments, various adjustments, and then when you—look at it over the years, you will see a trend that is increasing.

Mr. **Wyden**. One last question. What we are really concerned about is that defense contractors, the Department of Defense, the GAO, even our own investigators, claim that offsets are increasing. Yet your data seems to show they are decreasing. I would like to hear—I know we have touched on this indirectly What is behind your finding offsets are decreasing when everybody else says they are increasing?

Ms. **Stern**. We surveyed for the years 1980 through 1984, and there is a 1-year dip in that. However, if you make the kinds of adjustments in the obligation ratio, for example, you will see that the trend is increasing, and I think these adjustments are fair adjustments, and if you made those kinds of adjustments—for example, assuming that you had the obligation to sales ratio equaling 10 percent greater than that of 1983, then you would have a total of obligation to sales of $11.6 billion instead of the actual figure for 1980 to 1984 of $8.8 billion.

Mr. **Wyden**. But, Dr. Stern, just using your own chart, it is not a 1-year fluctuation. In 1980, it was 94 percent, and in 1984, it was 52 percent. So there was a major reduction and not a 1-year kind of fluctuation.

Mr. **DeMarines**. Table 1, I believe you are referring to——

Mr. **Wyden**. Right.

Mr. **DeMarines** [continung]. Is not a measure of obligation. It is only a measure of the export sales contract. The first column is the total sales reported—total military sales reported by our respondents. The second column is the total military sales that involved an offset, and the ratio is just a ratio of the two. It really doesn't——

Mr. **Wyden**. It shows deals involving offsets were declining, at least your table does.

Mr. **DeMarines**. But it doesn't show the obligations that were associated with those.

If you will refer to the graph on page 23, you will see the ratio of obligations to sales is increasing during 1980 to 1983, and it drops in 1984.

Mr. **Wyden**. Well—excuse me, do you want to add anything?

Mr. **DeMarines**. I just want to say, the reason for the drop in 1984 is because many of the obligations that are associated with those sales agreements have not yet been signed during that period. So, therefore, we assume, since there is a lag of anywhere from 2 to 3 years sometimes, in the obligation, that the figure in 1984, if we measure future obligations, will increase.

Mr. **Wyden**. Let me tell you what the subcommittee's concern really is. We all recognize there may be understatements in the data for reasons that were mentioned, but we are concerned the report may be misinterpreted because of those understatements. It seems to me a plausible situation because of time lags, your reports really could be used by those who want to keep the problem hidden, and quite possibly the level of offsets may be doubled the size your report indicates, and we are extremely concerned that your caveat of understatement be loud and clear because of information we are getting elsewhere in the Government.

In fact, the Treasury Department study several years ago showed over a 5-year period, in addition to approximately $9 billion in associated offsets, there were coproduction agreements totaling almost $14 billion. And I think set against this backdrop, our concern is that your report could be misinterpreted and used by people who really want to cover this problem up rather than this—what this subcommittee wants to do is get it out in the open and finally get a clear coherent Government policy articulated by the several agencies that have a direct stake in the matter.

I want to yield to my colleague from Ohio.

Mr. **Luken**. Dr. Stern, I am just fascinated by the list. I am going to have to come back to this, this list of positive results to the companies of offset requirements, of their willingness to comply. At one point you say, according to respondents, offsets have virtually affected the competitiveness of their companies, that is their individual companies, right? Did you ask whether it affected the competitiveness of the domestic industry that they belong to?

Ms. STERN. I don't believe we did.

Mr. LUKEN. Isn't that a significant omission? You are involved in trade. These folks would have a lot of information on that, wouldn't they? That is the question we really want to know. We don't really want to know whether individual companies made off like a bandit in this case, we want to know how the United States industry did, don't we?

Ms. STERN. I would turn the question and say, do you really think those respondents would have said while they are making off like bandits their fellow firms were hurting?

Mr. LUKEN. Sure, I do. I think it would be a logical question to ask them, what effect they thought it would have on the domestic industry that they were a part of, sure.

Ms. STERN. We found on the overall question of imports that were coming back into this country that it totaled $211 million, now, as a result of these offset obligation practices. To that extent we were able to see some impact rebounding to the United States in a, if you will, negative way.

Mr. LUKEN. When you go on to say although the reported positive aspects of offsets outweigh the negatives of such transactions—what do you mean by that, the reported positive aspects of offsets outweigh the negatives of such transactions? How do you derive—what do you derive that conclusion from?

Ms. STERN. It is a summary of the reported responses—of the responses that came in.

Mr. LUKEN. I assume you asked them to list the benefits and disadvantages. Did you ask them to weigh the individual positive considerations to the negative ones?

Ms. STERN. No.

Mr. LUKEN. Then it is pretty worthless, isn't it?

Ms. STERN. I think it is a perfect opportunity for self-serving responses.

Mr. LUKEN. I don't see any problem with the responses; I see problems with the questionnaire and your evaluation of it. If you ask somebody to list the positives and list the negatives, they might have a negative that outweighs completely 100 positives, but you didn't ask them that. I never heard of conducting a survey that way. Just tick them off, and then you come to the conclusion that the reported positive aspects of offsets outweigh the negatives—I don't understand that—just because it is a longer list.

Ms. STERN. I think that is right.

Mr. LUKEN. As I say, I really don't understand that at all.

Mr. DEMARINES. May I respond to that?

Mr. LUKEN. Surely. I would like some enlightenment.

Mr. DEMARINES. We asked the respondents—and we were told that if they did not agree to an offset, they would not have, in many cases, received the export sale. If you look at that aspect, then it is a very positive—accepting offsets has a very positive effect, and that is what that statement is based on.

Mr. LUKEN. Sure, they were competing with other companies. That is the whole problem. You have just put your finger on the problem, because we do not have a policy, we put our different—United States companies, American companies, in competition with one another so that they act at times in a way that is not beneficial, that is inequitable to the United States and its trade concerns, because we don't have the policy, we don't have the control, we don't have the mechanism the GAO mentions or the company I have talked to, one of the gentlemen said we need the Government to step in so we aren't required to do this, so we aren't required to get into cutthroat competition with our own companies that makes us submit to this business, which results in the importation of—or the exportation of technology, of our technology, and the importation of goods in competition with American producers. I think you just put your finger on it.

But I don't understand why you don't—we come to completely different conclusions. All of your conclusions arise from the fact what you see is a good I see as an evil, and the contractors I have talked to consider it as an evil. They are required to submit—they were coerced into this barter, into this offset, because if they don't do it, some competing American company will do it. Shouldn't we try to relieve them of that obligation? Aren't there good policy reasons why we shouldn't try to do that? That is a trade question, isn't it?

Ms. **Stern**. I think it is a policy question. We did not, you are right, do this kind of a study to make those policy conclusions. We were only doing this survey. I believe that these are critical questions for American competitiveness in the world, its potential for either growth or deterioration. I think in a sense that is the reason we self-initiated the study, to try to get a data base on this, so that policymakers, both like yourselves and those in the executive branch, can get together and establish a policy.

But we do not pretend to be policymakers. We are factfinders. Now, if you think that the facts have been skewed by the questionnaire itself, that is a fair criticism. I would simply say that we try to get as much as we can with as small a questionnaire as possible in order to get it out.

Mr. **Luken**. Well, I won't persist on this, but I want to make one point. Mr. Conahan, you bring up in your report the examples of South Korea and Japan, and I read recently where we provide about $50 billion per year to the defense of the Pacific rim around Japan, which includes South Korea, and whereas we are providing $50 billion of U.S. taxpayer funds for the defense of these countries, in providing, such as Korea, I am sure we provide them a lot of material—do we not?

Mr. **DeMarines**. Yes, sir.

Mr. **Luken**. In addition to even providing troops from time to time. And at the same time, Korea and Japan have these policies they have extracted from us, these offsets from our contractors. I think it is shocking. I have run out of time.

Mr. **Wyden**. I would like to recognize minority counsel.

Mr. **Smith**. I would like to ask you a couple questions. You stated in your testimony $1 billion in contracts were lost, according to the contractors, from 1980 to 1984, because they refused, were unwilling, or for whatever reason, did not agree to the offsets required. Does this indicate if actions were taken to substantially restrict the ability of American defense contractors to enter into offset agreements they would lose significantly more contracts?

Ms. **Stern**. Well, they wouldn't lose them to their fellow American firms, who would probably be subject to the same requirement, the same restriction. And to the extent the United States does dominate in many of these areas, they probably would not have the kind of foreign competition, would not have that kind of restriction on them.

To the extent you do have foreign competition, then you would be in the same kind of situation where you get a company saying, well, they get subsidized financing from the French banks, they ought to get the Eximbank subsidized financing. It is a similar problem.

Mr. **Smith**. Did your questionnaire or your conferences with any of the contractors indicate how dominant the United States actually is in the sense of how much of what we are contracting overseas is subject to foreign competition?

Ms. **Stern**. Eighty percent of the offset sales involved aerospace, and that, you know, you can use as some kind of key as to what our competition is. Did we ask if there was foreign competition for bidding on the offsets?

Mr. **DeMarines**. Yes.

Mr. **Smith**. What kind of response did you get?

Mr. **DeMarines**. The contractors are bidding for foreign sales against foreign competition; yes.

Mr. **Smith**. In most cases?

Mr. **DeMarines**. Yes.

Mr. **Smith**. They are not just competing with themselves, they are competing with people who would not necessarily be subject to restrictions on agreeing to offset requirements?

Mr. **DeMarines**. That is correct.

Mr. **Smith**. Mr. Conahan, is that something you believe to be the case as well?

Mr. **Conahan**. I don't have comprehensive information on it, but we do have examples of where there was competition from foreign competitors as well as competition among U.S. competitors.

Mr. **Smith**. Dr. Stern, you testified that in many offset cases, there were no actual imports. Can you clarify what that means?

Ms. **Stern**. Well, when you have an offset obligation, you are obliged to do a number of things, including licensing production, coproduction, technology transfer, investment overseas; and you may also be obliged to take product. That product may be disposed in the United States, or it may be disposed overseas in a third market. So that is the reason why I said it may not necessarily result in actual imports into the United States.

Mr. **Smith**. I take it you came upon examples of product that a defense contractor was required to dispose of in a third country.

Ms. **Stern**. No.

Mr. **Smith**. So the $211 million of imports coming back in is not indicative of the overall impact on the U.S. trade deficit or the U.S. economy of the offset requirements?

Ms. **Stern**. No, it is just indicative of the actual imports that have come in. There may be imports which will come in down the line, given the lag we were talking about. It may be—and this is the reason why I put in my statement and I don't think it has been fully appreciated—the point I was trying to make about hindering our long-term competitiveness, and adversely affecting other U.S. companies, because of this potential impact that results from offset requirements for technology transfer, which means that you are transferring technology overseas for your competition to then enjoy, produce products which may ultimately appear in the U.S. market.

Mr. SMITH. Without necessarily producing immediate impact on the trade deficit?

Ms. STERN. Without necessarily having an immediate impact. That is why I emphasize the word "potential."

Mr. SMITH. Thank you, Dr. Stern.

Mr. WYDEN. I thank minority counsel.

The gentleman from Texas.

Mr. BRYANT. Thank you, Mr. Chairman.

Mr. Conahan, you stated in your testimony many countries have laws or policies requiring offset, and we heard from Dr. Stern that U.S. defense contractors were bartering weapons for shoes, textiles, furniture, even automobiles or motor vehicles. How pervasive is the problem of foreign countries requiring offsets by law?

Mr. CONAHAN. We were looking to the ITC study and OMB study to answer how pervasive the practice is. I think that we can say, based on our work, that it is pervasive. We have seen that in excess of 30 countries do require offsets in order to do business with them. The more you study it, the more you find that countries do require it, and they get to the point of being very specific in terms of what the level of offset needs to be; it runs from 35 percent to 50 percent to 100 percent. The more we and others study it, the more pervasive we find it to be.

Mr. BRYANT. They are, in effect, expanding their own civilian industries at our expense while fulfilling their defense needs, are they not?

Mr. CONAHAN. I think it is clear they are doing that. A good example of that is the Saudi requirement where companies need to make direct investment in Saudi local manufacturing concerns.

Mr. BRYANT. It would seem that the justification of standardization, interoperability or a two-way street, would not have any merit when Turkey requires General Dynamics to invest in projects like the Hilton Hotel in Ankara as part of a F-16 sale.

Mr. CONAHAN. I don't have any knowledge of that requirement, but given that is the case, certainly I don't think that is justified by standardization. I think in the first instance, the sale of the F-16 might be considered as furthering interoperability and standardization, but certainly not the hotel.

Mr. BRYANT. With regard to Greece, they apparently want General Dynamics to cure their sick industries. Don't we already give Greece security assistance?

Mr. CONAHAN. Over the last 2 years, we have made available FMS financing to the tune of $1 billion to Greece. And, indeed, as part of their propsoal, they have asked that the company provide assistance for their problem industries.

Mr. BRYANT. That leaves us in the position of curing their economies while at the same time we provide all their defense needs.

Mr. **Conahan**. Absolutely, sir. We have been doing that for years in a number of these countries.

Mr. **Bryant**. Don't these countries select what they perceive to be the best aircraft, weapons, and missiles and so forth to meet their defense needs, or do they select the contractor, whatever is acceptable, with the best offset packages?

Mr. **Conahan**. I think the countries consider a number of things. There are political considerations, military considerations and economic considerations. To the extent that these offsets loom large in terms of economic benefits, I would expect that we would see increased usage or demands for these offsets.

Mr. **Bryant**. Depending on the political circumstances of those countries?

Mr. **Conahan**. Yes, sir.

Mr. **Bryant**. Are there circumstances where those countries will select a less capable military system if the manufacturers are willing to promote more of their exports?

Mr. **Conahan**. Yes. One good example has to do with the selection by the Netherlands of the German-built Leopard 2 tank over the American M-1 tank. Even though the Netherlands military believed the M-1 would perform better than the German tank, the German offset package was sweeter than the American package, and they selected the German tank.

I might add that the cost of the German tank is something on the order of 15 to 20 percent higher than the American.

Mr. **Bryant**. That is incredible. That means that our allies are compromising their defense readiness, as well as ours, in order to sell more textiles or more home-grown goods.

Mr. **Conahan**. To the extent—we will agree that the M-1 tank is better than the Leopard, that follows, I suppose.

Mr. **Wyden**. I think the gentleman's question is very much on point. I think the situation is just bizarre. The contractors are essentially running a foreign aid program, is that right, for economic development?

Mr. **Conahan**. There is clearly that element there.

Mr. **Wyden**. I think it is just bizarre, and it is the gentleman's time from Texas.

Mr. **Luken**. Would the gentleman yield?

Mr. **Bryant**. Yes.

Mr. **Luken**. The Netherlands is part of NATO, right?

Mr. **Conahan**. Yes, sir.

Mr. **Luken**. Don't we have agreements in NATO on such purchases?

Mr. **Conahan**. If you consider the Germans use their own tank, there is some standardization between the Netherlands and Germany on this. I can't really comment beyond that.

Mr. **Wyden**. The gentleman from Texas.

Mr. **Luken**. I guess it is horribly complex.

Mr. **Bryant**. Is there any mechanism in the United States that limits or curtails the ability of our defense contractors to negotiate away business in other industries?

Mr. **Conahan**. I am aware of no barriers on that. That is to say, I know of nothing that would stand in the way of our defense contractors dealing directly with foreign governments.

Mr. **Bryant**. How is it—I heard you say earlier some sales involve more than 100-percent offsets—how does that happen?

Mr. **Conahan**. The question was raised here earlier concerning competition—is there really competition among ourselves and others as well as among our own defense contractors? And indeed there is. A good case in point is the sale—the ultimate sale of the F-18 to Canada. There were other U.S. defense contractors attempting to get that sale, and that sale ultimately was bid up to the point where the offset is almost 107 percent of the sale value. There is both direct offset in the way of coproduction, and there is indirect offset in the way of helping Canada out with its tourism industry as well as for the sale of spare parts for civilian aircraft.

Mr. **Bryant**. So with regard to the F-18 sale to Canada, a company like McDonnell Douglas can negotiate away as much business from other U.S. industries as it would like to do, is that correct?

Mr. **Conahan**. Yes, sir, and has in this case.

Mr. **Bryant**. During these negotiations, is anyone there representing the offset industries, the ones who are going to lose, the domestic industries that are going to lose?

Mr. **Conahan**. We have no direct knowledge of anyone being there.

Mr. **Bryant**. So there is no protection for those affected industries at all?

Mr. **Conahan**. To the extent they are absent, their interests would not be tended to, I suppose.

Mr. **Bryant**. I presume the defense contractors in the F-18 case are concerned only about their bottom line, not about anything else.

Mr. **Conahan**. I see nothing to support another concern.

Mr. **Bryant**. You stated in your report on the Japanese coproduction of the F-15 that Japan's aircraft industry grew and developed largely through U.S. military coproduction programs. I think you said much of the technology transferred to these programs is commercial—has commercial application and now using that experience and technology, the Government of Japan is assisting in the development of the civil aircraft industry at home along with other high technology industries.

Reflecting on your coproduction arrangement with Japan and its benefits to Japan's civil aircraft industry, would you comment on why we do that kind of thing?

Mr. **Conahan**. As we just said, often times offsets are required because of competition. However, there are other considerations involved in granting these offsets as well. Certainly foreign policy and national security considerations need to be taken into account. I think in reviewing the Japan situation, one needs to reflect on our relationship with Japan over a long period of time. We began coproduction arrangements in Japan in the early 1950's. We started with the F-86 fighter aircraft, the T-33 trainer, for example. We went on and coproduced the F-4 and 104, then got into the P-2 and, more recently, the P-3, maritime patrol aircraft, and most recently, the F-15.

That was handled almost exclusively by the Department of State and the Department of Defense, and our concern there is that other agencies that should be looking out for the economic interests of the United States were not involved in that series of coproduction projects. The Department of Commerce, the Department of Treasury, the Department of Labor, the U.S. Trade Representative didn't really have a voice, or much of a voice, in that whole series of coproduction projects as a result of which we did transfer a lot of technology to Japan.

Mr. **Bryant**. It seems to me in view of our fantastic trade imbalance, with Japan particularly, it is fair to ask how these deals could continue to be tolerated.

Mr. **Conahan**. I should think we are in part leading to an answer to that question here today, sir. Hearing inquiries such as this should shed light on that and hopefully lead us to some answers.

Mr. **Luken**. Would the gentleman yield?

Mr. **Bryant**. Yes.

Mr. **Luken**. With regard to Japan, I believe they have a cap on their military spending. Is that right?

Mr. **Conahan**. Yes, sir. One percent of gross national product.

Mr. **Luken**. Since you have outlined that Japan has chosen to coproduce some of this aircraft, even despite the fact that Japan—it is twice as expensive for them to do so. They have no incentive, therefore, to take the more economical route, do they, because they bump up against the ceiling of their 1 percent. So what we are doing, therefore, is providing all of their defense over the 1 percent and, therefore, they have every incentive to, in effect, waste money in order to protect their own competitive concerns in developing their own technology rather than buying the more economical point or more economical product, right?

Mr. **Conahan**. Yes, sir.

Mr. **Luken**. Because of the particular arrangement. We would directly pay a premium then. We pay twice and pay a premium besides.

Mr. **Conahan**. We certainly provide in the first instance the defense umbrella, and they do, in my view, spend some of their funds inefficiently in terms of defense application, but certainly there are——

Mr. **Luken**. They have no incentive whatsoever to be efficient or economical.

Mr. **Conahan**. They certainly again benefit from paying two or three times as much for an defense items in terms of technology they gain, for application elsewhere in their economy, than they would from buying these things directly from the United States.

Mr. **Luken**. We have limits as to how much we will pay, I think we do. At least in terms of the law, we do. But they have no limit except the 1 percent.

Mr. **Conahan**. There are two current coproductions. One involves the air defense system, and another one the AIM 9L Missile. If we could get the Japanese to buy those directly from our contractors rather than coproducing them, that would help us as well.

Mr. **Wyden**. If we might, let's turn to the issue of the foreign military sales credits. You stated there were a number of companies getting assistance that were requesting and presumably receiving offsets. Aren't we talking essentially about double-dipping?

Mr. **Conahan**. We have some difficulty in seeing continued justification for that practice. I think it is reasonable to ask the question, why we would agree to offsets when, in fact, we have essentially given the defense article away or at least financed it at a very concessional rate. I think the DOD witness may later today state that it is DOD policy not to use FMS credits in the case of direct offsets, that is to say coproduction and licensed production, and that they discourage the use of FMS credits when indirect offsets are involved. But we have seen any number of exceptions to that policy, sir.

Mr. **Wyden**. That is my understanding, and I think we are going to hear that later as well. But in a 1984 report, our report on trade offsets, we didn't see that there was that clearly defined policy. We stated then the offset could be used by the FMS recipient company to expand its own industrial base, and U.S. jobs. We believe FMS credits should not be used directly or indirectly to expand the base of a FMS recipient at the expense of a U.S. industrial base and U.S. jobs.

What we are interested in knowing is whether you would recommend applying direct offset financing policy, applying that to the indirect offset financing policy as well.

Mr. **Conahan**. I think, Mr. Chairman, in theory, I would like to join your assertion to that statement. I think that in terms of both indirect, as well as direct, it is difficult to see the justification for FMS credit or grant funds to be used.

However, the indirect offsets essentially are arrangements between a private contractor in this country and a foreign government, and I don't really see how the Government gets involved in that kind of a transaction. I think it requires study. Conceptually, theoretically, what you say I can buy into, but I see a lot of difficulties with it.

Mr. **Wyden**. So you are saying that the reason this recommendation wasn't adopted is it takes more study but that you basically think it is a practical, good recommendation?

Mr. **Conahan**. I would like to back away from the term practical. That is where, at the moment, I have a hangup. I say conceptually, theoretically, yes, sir, but I don't know how to do it myself.

Mr. **Wyden**. We are interested in finding out why the recommendation wasn't followed, and of course, welcome your further analysis of it and perhaps we will learn a little bit more from Dr. Crossman of the DSAA ths afternoon.

Mr. Conahan, we have a vote on the floor but Chairman Dingell is particularly interested in one matter and wanted very much to be here and that is a concern that there be an adequate, reliable data base for offsets.

So on behalf of Chairman Dingell, who very much wanted to be here, the subcommittee would appreciate it if the GAO would review the two studies that were mentioned here today to determine if they can be the basis for public policy decisions. Would you be willing to accede to the request of Chairman Dingell?

Mr. **Conahan**. Yes, sir.

Mr. **Wyden**. Unless our witnesses have further comment you will be excused. The subcommittee will break for this vote and we will return momentarily. We thank you for your cooperation.

[Brief recess.]

Mr. **Wyden**. The subcommittee will come to order.

Our next panel, Mr. John Richards, Director, Office of Industrial Resource Administration, Department of Commerce; Mr. Gregory K. Schoepfle, Director, Division of Foreign Economic Research, Office of International Economic Affairs, Bureau of International Labor Affairs, Department of Labor.

Gentlemen, we very much appreciate your cooperation and your attendance today. Let me advise you, you have the right to counsel to appear with you at all times and also a right to a copy of the subcommittee rules throughout your appearance here today.

Do either of you gentlemen have an objection to being sworn as is the practice of the subcommittee?

Mr. **Richards**. No.

Mr. **Schoepfle**. No objection.

Mr. **Wyden**. If not, please rise and raise your right hand.

[Witnesses sworn.]

Mr. **Wyden**. Let me say at the outset that we will make a copy of your prepared remarks a part of the hearing record and in the interest of time we would very much appreciate it if you would just highlight your principle concerns today and then we can move right to questions and we will make the copy of your prepared remarks a part of the hearing record in their entirety.

Why don't we begin with you, Mr. Richards?

TESTIMONY OF JOHN A. RICHARDS, DIRECTOR, OFFICE OF INDUSTRIAL RESOURCE ADMINISTRATION, DEPARTMENT OF COMMERCE; AND GREGORY K. SCHOEPFLE, DIRECTOR, DIVISION OF FOREIGN ECONOMIC RESEARCH, OFFICE OF INTERNATIONAL ECONOMIC AFFAIRS, BUREAU OF INTERNATIONAL LABOR AFFAIRS, DEPARTMENT OF LABOR

Mr. **Richards**. Thank you very much, Mr. Chairman.

I am pleased to have the opportunity to appear before this subcommittee today to discuss the complex issue of military offsets. As you are aware, offsets have become a subject of increasing interest both in the Congress and in the administration.

In defense trade, offsets are defined as a range of industrial and commercial compensation practices required by a purchasing government or company as a condition of purchase of defense articles and defense services. Offsets in defense related exports are frequently divided into direct and indirect classes. All areas of U.S. defense exports are subject to both direct and indirect offsets.

Requiring and granting offsets as part of military sales purchasers has taken place for various reasons including: Promoting broad U.S. foreign policy/national security objections; meeting foreign sales competition; fostering military interdependence; strengthening and expanding the allied defense industrial base; stimulating total allied defense spending; and, generating balance of payments benefits.

Traditionally, there has been agreement within the Western Alliance that direct offsets are beneficial for security reasons. For example, during the early post-World War II period, arms transfers and offsets, played an important role in rebuilding the defense base infrastructures of our allies.

More recently, NATO arms transfers and offsets have been promoted for military and economic objectives: to promote th NATO strategy of rationalization, standardization, and interoperability, RSI, to make military hardware trade within the Alliance.

Mr. **Wyden**. Mr. Richards, again, we will make a copy of your prepared remarks a part of the record in their entirety. What we are particularly interested in is your knowledge about offsets particularly, the role of offsets and we will make your full remarks a part of the record.

Mr. **Richards**. Thank you. I will summarize very quickly then.

There are both benefits and problems associated with the offsets. The benefits I have mentioned deal with national security and foreign policy objectives. Offsets have resulted in trade benefits to the United States and enabled us to be competitive within world markets.

However, they have also created some problems in increasing the costs of weapons systems to both purchasing countries and the selling countries. We in the Department of Commerce have been invited to participate in a study mandated under the Defense Production Act and my office has been delegated the role in working within the interagency community on that particular study.

We are not in a position to discuss the details of any conclusions for that study. However, we have some general observations with regard to the study that we have conducted or participated in in the interagency community and also in another survey that we conducted of the U.S. foreign commercial service posts within the Department of Commerce.

Some of the observations that we have with respect to our study with the foreign commercial service posts indicate that military offsets have become a central factor in awarding military contracts by foreign governments; the range and magnitude of required offsets have increased in the last 5 years; and that the nature of military offsets demanded have increasingly tended towards arrangements which include technology transfer and production and management knowhow.

The technology obtained has often been applicable to commercial industries selected by the purchasing governments for growth and development. Foreign governments have also begun to codify official policies and procedures concerning offsets in military trade.

An excellent example of the benefits and problems associated with offsets can be drawn from the F-16 fighter aircraft offset program with the European participating governments.

In early 1974 the NATO nations of Belgium, Denmark, the Netherlands, and Norway formed a consortium for the common purchase of fighters to replace their aging F-104G aircraft. The nations of Sweden, France, and the United States were invited to submit proposals to supply the aircraft.

The U.S. entry in the competition, the F-16, was still in the prototype stage. The Swedish and French entries were already operational. In January 1975, the Air Force announced its decision to produce the F-16. Within 5 months the EPG announced its preference for the F-16. Central to the EPG decision were the offset terms offered by representatives of the U.S. Government during the negotiations which developed between January and June 1975.

The Department of Commerce believes offsets are an important component of our national security and foreign policy. The Department will continue its analysis of the issue in this coming year in the hopes of providing a balanced and objective source of information that will assist both the Congress and the Administration in the contribution of offsets in U.S. export trade.

In closing, let me thank the subcommittee for the opportunity of presenting my views. I will be responsive to your questions, sir.

[The prepared statement of Mr. Richards follows:]

STATEMENT
OF
John A. Richards
Director
Office of Industrial
Resource Administration
Before the
U.S. House of Representatives
Subcommittee on Oversight and Investigations
of the
Committee on Energy and Commerce
October 10, 1985

Good morning. Mr. Chairman, I am pleased to have the opportunity to appear before the Subcommittee on Oversight and Investigations to discuss the complex issue of military offsets. As you are aware, offsets have become a subject of increasing interest for both the Congress and the Administration.

In defense trade, offsets are defined as a range of industrial and commercial compensation practices required by a purchasing government or company as a condition of purchase of defense articles and defense services. These practices may include: barter, countertrade, coproduction, technology transfer, mandatory subcontracting, overseas investment, licensing or other arrangements for the transfer of advanced production processes and management skills. Offsets in defense related exports are frequently divided into direct and indirect classes. Direct offsets involve goods and services related to the defense export item in the sales agreement. Indirect offsets involve goods and services not related to the defense export item in the sales agreement. All areas of U.S. defense exports are subject to both direct and indirect offsets.

Requiring and granting offsets as part of military sales purchases has taken place for various reasons including:

- Promoting broad U.S. foreign policy/national security objectives;
- Meeting foreign sales competition;
- Fostering military interdependence;
- Strengthening and expanding the allied defense industrial base;
- Stimulating total allied defense spending; and,
- Generating balance of payments benefits.

Traditionally, there has been agreement within the Western Alliance that direct offsets (coproduction. licensed production and technology transfer) are beneficial for security reasons. For example, during the early post-World War II period, arms transfers and offsets, particularly coproduction, played an important role in rebuilding the defense base infrastructures of our allies.

More recently, NATO arms transfers and offsets have been promoted for military and economic objectives: to promote the NATO strategy of rationalization, standardization, and interoperability (RSI), to make military hardware trade within the Alliance a "two-way street", and to meet foreign sales competition.

However, as U.S. arms transfers have increased over the years, there has been a growing awareness by foreign buyers that defense purchases can be leveraged beyond these security objectives to stimulate economic growth and to enhance technical capabilities.

As our defense allies have became more affluent, they have established more extensive and sophisticated defense industrial capabilities. They have also established themselves as competitors to the U.S. in international arms trade markets. With this rise in competition, offsets are becoming a systemic and growing element of arms trade, which U.S. corporations must effectively manage to remain competitive in international markets.

This change in the role and extent of offsets in U.S. military export trade has stimulated considerable interest on the part of Congress and the administration. In April 1984, the Congress, under the authority of Section 309 of the Defense Production Act, mandated that the Administration report to the Congress on the effects of military offset agreements on U.S. defense preparedness, trade, employment and industrial competitiveness.

Your letter of invitation expressed an interest in being briefed on the progress the Department has made with respect to this report. The Secretary of Commerce assigned my Office the responsibility of developing the chapter of this study which addresses the effects of military offsets on U.S. industrial competitiveness. Considerable progress has been made in developing the assessments required for the report. However, because of delays in obtaining the survey data, the Administration has been forced to request an extension for submitting the first report to Congress. Because the study has not been completed, I am not in a position to speak definitively about the impact of offsets on U.S. industrial competitiveness.

I can however, provide some general observations about offsets in defense trade. The fact that U.S. firms increasingly face the requirement of providing offsets in order to procure sales has several connotations for the United States. The most obvious is that offsets in the form of coproduction, licensed production and directed subcontracting do divert some business from the U.S. defense base. Both indirect and direct offsets also have the effect of enhancing the capabilities of foreign competitors through transfer of technology and production know how. Judgment on these effects must be tempered, however, by the realization that the alternative in many cases may be the loss of the total sale.

The point to be made is that offsets are not a simple economic or trade issue that can be judged from a conventional economic perspective. Rather, they are a complex factor of military trade involving strategic national security and foreign policy considerations, as well as the more tactical consideration of U.S. military export sales.

The sale of the F-16 fighter aircraft to the European Participating Governments (EPG), a consortium of NATO European countries, provides a particularly well documented example of this current role of offsets.

In early 1974, the NATO nations of Belgium, Denmark, the Netherlands and Norway, formed a consortium for the common purchase of fighters to replace their aging F-104G aircraft. The nations of Sweden, France and the United States were invited to submit proposals to supply the aircraft. The U.S. entry in the competition, the F-16, was still in the prototype phase. The Swedish and French entries were already operational. In January of 1975, the Air Force announced its decision to produce the F-16. Within five months, the EPG consortium had announced its preference for the F-16.

Central to the EPG decision were the terms offered by representatives of the U.S. Government during the negotiations which developed between January 1975 and June of the same year. The Memorandum of Understanding (MOU) that resulted from these negotiations set forth the basic principles that would govern the sale, including the stipulation that the Department of Defense would require the U.S. contractors to coproduce the F-16 with the EPG.

Under the terms of the MOU the nations of the EPG were to receive offsets totalling approximately 58 percent of the purchase price of the 348 F-16 aircraft to be delivered to these nations. These offsets were to be provided essentially through work on the F-16 itself, although provision was made for any shortfalls to be provided through alternative trade.

There have been numerous short-term gains for U.S. contractors who were able to participate in the program (i.e. those firms whose products were not coproduced for the EPG F-16 program). A 1981 study by the DOD/U.S. Air Force highlights these economic gains, with data obtained through a survey of F-16 contractors. Contractors benefited through the sale of equipment, technology and licensing fees that would not have been possible in the absence of the coproduction arrangement.

On the other hand, this coproduction diverted some business away from efficient U.S. defense base contractors. Furthermore, coproduction raised unit costs and reduced efficiencies for both the EPG and the United States. An Air Force/Rand Corporation study titled "Multinational Coproduction of Military Aerospace Systems" estimates that the F-16 fighters, coproduced in Western Europe, are approximately 35 percent more costly for the EPG's than purchasing the aircraft directly from the U.S. manufacturer. Similiarily, there were costs to the U.S. Government due to smaller production runs, lost R&D recoupment charges and the procurement of subcomponents manufactured by more expensive European subcontractors. Overall, the EPG F-16 coproduction agreement provides a fairly generic example of the characteristics of offset-related military trade.

Information on the future outlook for offsets in foreign military trade was gathered by a Department of Commerce survey of 26 U.S. Foreign Commercial Service Posts. The responses clearly outline several trends in foreign government policies;

- Military offsets have become a central factor in awarding military contracts by foreign government;
- The range and magnitude of required offsets has increased in the last five years;
- The nature of military offsets demanded has increasingly tended toward arrangements which include technology transfer and production and management know-how;
- The technology obtained has often been applicable to commercial industries selected by the purchasing government for growth and development; and

- Foreign governments have begun to codify official policies and procedures concerning offsets in military trade.

The results of this survey indicate that offsets will continue to be a major factor in U.S. defense export trade for the forseeable future.

The DOC believes that offsets are an important component of our national security and foreign policy. The Department will continue its analyses of this issue in the coming year, in hope of providing balanced and objective information that will assist the Congress and the Administration in the consideration of offsets in U.S. defense export trade. In closing, let me thank the subcommittee for the opportunity of presenting the Departments views today.

Mr. WYDEN. We will have some questions for you momentarily, Mr. Richards.

Mr. Schoepfle.

TESTIMONY OF GREGORY K. SCHOEPFLE

Mr. SCHOEPFLE. Mr. Chairman, members of the subcommittee, I am pleased to appear before you today to participate in this public hearing on foreign military sales and offsets associated with such sales. My remarks will be primarily directed at our current efforts to estimate the domestic labor impact of such sales and offsets.

As you probably know, the Department of Labor is not involved in the negotiations for the sale of military equipment, whether here or abroad.

It does, however, have an interest in the issue since such sales have an impact on the patterns of domestic production and employment. This interest is heightened in the case of military sales to foreign countries since such sales have at least the potential for affecting U.S. employment, both absolutely and relatively to employment abroad.

For example, military export sales, whether or not they are associated with offsets, have an effect on production and employment in a number of domestic industries. Typically, we tend to associate sales or exports with increases in domestic production and a favorable impact on domestic employment.

Export sales which are predicated on some sort of an offset transaction have a favorable impact on domestic production and employment, but the offsets themselves may reduce the size of the favorable impact in the exporting industries or actually have an adverse impact on one or more import-competing industries.

The Department of Labor's interest in this matter is of course reflected in its current involvement in the research and preparation of the President's report to Congress on the domestic effect of military sales and offsets.

Specifically, section 309 of the Defense Production Act Amendments of 1984 directed the President "to submit a report on the impact of offsets on the defense preparedness, industrial competitiveness, employment and trade of the United States."

The preparation of the report is being carried out by an interagency coordinating group chaired by OMB. The Department of Labor participates fully in the activites of the group and has the lead in the preparation of the chapter of the report which assesses the impact of military-related sales and offsets on domestic employment.

From the inception of the coordinationg group, the Department of Labor made it clear that it could not develop estimates of the domestic labor impact of military-related sales in which offsets are required in the absence of data on the types and volumes of sales and offsets. At a minimum, we felt we needed information on the industries affected by both sales and offsets and the magnitudes and timing of these flows.

My department supported the efforts of the coordinating group in the development of a data base on offsets in defense-related exports through a survey of U.S. corporations involved in these practices. For a number of reasons, delays occurred in obtaining and processing the data.

I am pleased to report that we have made considerable progress in these steps and are now very close to the point where we can begin to carry out our analysis. As a result of these delays, however, the administration has been forced to request an extension of time in submitting the first report to Congress.

Mr. Chairman, when our study is completed, I will be happy to make copies available to you and the subcommittee. In the meantime it may be useful to discuss our general views on the mechanisms through which military-related sales and offsets may affect domestic employment.

At the outset it must be recognized that there are several different types of offset arrangements: coproduction, licensed production, subcontractor production, overseas investment, technology transfers, countertrade, et cetera. Not only is the effect of each of these forms of offsets on domestic production and employment likely to be different, but so is our ability to measure it.

For example, licensed production abroad of a part or component of a U.S.-origin defense article may be perceived as reducing potential U.S. output since the item will not be exported from the United States to the purchasing country and that country may sell the item to third countries, thereby displacing potential U.S. exports. Conceivably, data can be obtained for this type of transaction which will enable us to derive one or more estimates of the domestic employment effects of such licensed production arrangements.

Similarly, offsets which involve countertrade may affect the production and employment in one or more import-competing industries, including industries unrelated to the production of military hardware. In this case, too, precise data on the types and volume of the two-way flow of goods and services can enable one to derive rough estimates of their impact on domestic employment.

However, should the offset take the form of overseas investment, particularly if the investment is in an industry unrelated to the sale, it is more difficult to conceptualize the impact on domestic output and production and even more difficult to quantify. These and other factors require that we pay painstaking attention to the data prior to fulfilling our task of estimating the domestic employment effects of military sales and offsets.

Mr. Chairman, this concludes my prepared statement. At this time I would be pleased to address any questions that you or other members of the subcommittee may have.

Mr. **Wyden**. Gentlemen, thank you very much.

Beginning with you, Mr. Richards, is the Commerce Department consulted in advance by the Defense Department about the economic impact of specific offset deals that involve coproduction or license production?

Mr. **Richards**. No, we are not. Our role is limited to assessing the economic effects of offsets. We are participating with the Department of Defense and other agencies in the interagency study mandated by the Defense Production Act.

Mr. **Wyden**. Is there any formal mechanism whereby the Commerce Department can review or evaluate or approve the military sales that involve an offset?

Mr. Richards. Not to my knowledge.

Mr. Wyden. To your knowledge have any foreign military sales been canceled because of the potential impact of an offset?

Mr. Richards. Not to my knowledge.

Mr. Wyden. Has it been discussed? Has this been something that has even been discussed, the question of canceling foreign military sales?

Mr. Richards. I have no knowledge of such discussions within the Department of Commerce. Our focus is not on any individual transaction but on the aggregate effect. I don't think it would be fair to assess the potential impact on any individual agreement.

Mr. Wyden. Do you know whether or not it has been discussed anywhere else in government?

Mr. Richards. I do not know.

Mr. Wyden. Is it true that about 50 percent of the offsets are indirect?

Mr. Richards. I think at least 50 percent are indirect, possibly a higher percentage than that.

Mr. Wyden. Hasn't a very large part of the justification for offsets been that countries use them to build their defense capabilities and then promote a two-way street in arms trade?

Mr. Richards. That is one of the objectives. Another objective is to provide the economic capability to the purchasing country of obtaining the sophisticated weapons systems that add to the military strength of the alliance.

Mr. Wyden. But in reality aren't countries using offsets to expand their economy?

Mr. Richards. I think based on the survey that we conducted with our foreign commercial service posts, that it is an objective of many countries to focus on the economic benefits of offsets.

Mr. Wyden. Who demands the offsets? Are they developed countries, developing countries? Who is making the demands?

Mr. Richards. I think the demands are being made by countries of every caliber, developing countries and fully developed countries.

Mr. Wyden. But countries like Japan and Korea and Canada are all——

Mr. Richards. That is correct.

Mr. Wyden. Korea mandates offsets of a minimum of 50 percent.

Mr. Richards. Yes. The Korean Government recently established its policy on mandating offsets of at least 50 percent of every governmental transaction over $1 million or $2 million. I would have to check.

Mr. Wyden. Just as a factual matter some of the people who have demanded offsets have significant trade imbalances with our country.

Mr. Richards. That is correct.

Mr. Wyden. Is there justification for bartering with countries in one of the few areas I think today where we have potential for a big trade surplus?

Mr. Richards. One of the things we have to consider, and I believe our study will focus on it, is that the trade balance of the United States is affected in two different ways based on offsets.

One, we may lose the opportunity to participate in overseas sales if we don't accept the other government's policy of offsets.

On the other hand, we also may lose the opportunity of contributing more to the economy if offsets were not a part of these agreements. To date, we do not have an analysis of the balance of that equation. So not accepting the offset and losing the total contract could have a more serious effect on our balance of trade with each of these individual countries than accepting the offsets.

Mr. **Wyden**. Then where do some of these countries get off making these demands?

Mr. **Richards**. Countries are making the demands because the offsets are beneficial to them in general. There are some that have been proven to be not as beneficial as originally anticipated because the cost of the products are greater by coproducing or through offsets than they would be through direct purchase from the United States.

Mr. **Wyden**. According to the ITC survey, billions of dollars in commercial goods covering dozens of industries are imported into the country for us to make foreign military sales.

How does this practice affect our civilian industries and civilian employment?

Mr. **Richards**. We are still assessing the data provided by the International Trade Commission as to the exact level of imports into the U.S. based on offsets. It is very difficult to determine what imports really are a result of offsets. In our data collection we don't know if an import is tied to an offset or not. The data that was obtained by the International Trade Commission was provided by the company that had agreed to the offset, not necessarily the company that is marketing the material within the United States or marketing the material outside of the United States as a procedure for meeting the offset burden.

Mr. **Wyden**. But you are studying this. Our concern is increases in production and things in the military sector come at the expense of greater competition in the civilian sector. Do you think the evidence points to that?

Mr. **Richards**. I don't think we could reach that conclusion as yet, but that is a focus of our concern.

Mr. **Wyden**. Let me move to you, Mr. Schoepfle. Is the Labor Department consulted in advance by the Department of Defense with respect to the economic impact of specific offset deals?

Mr. **Schoepfle**. Not to my knowledge.

Mr. **Wyden**. Is there any formal mechanism where the Department can review or evaluate or approve military sales where there is an offset?

Mr. **Schoepfle**. Not to my knowledge.

Mr. **Wyden**. To your knowledge, has any foreign military sale been canceled because of the potential impact of the offset?

Mr. **Schoepfle**. Not to my knowledge.

Mr. **Wyden**. Do you know of any discussions that have taken place with respect to this subject?

Mr. **Schoepfle**. No.

Mr. **Wyden**. In your statement you stated that offsets have an impact on the patterns of domestic production and employment. Do you have emperical evidence there at the Department of Labor on this?

Mr. SCHOEPFLE. We are in the process of doing such as analysis. We recently received the full data on the sales and corresponding offset arrangements from the ITC through OMB. There were initial problems with the data that needed to be resolved; verifications and checks had to be made.

We are now in the process of trying to derive an estimate of the impact—giving a range of the employment effects of such sales and corresponding offsets. That work is in progress, so I can't really report at this time any preliminary results.

Mr. WYDEN. What kind of difficulties are there with the data, what kind of problems?

Mr. SCHOEPFLE. Well, as with all surveys, once you collect data, you wish sometimes that you would have asked other questions or asked a qustion in a different way. But in terms of reporting of the data, there were questions that needed to be checked back with respondents for clarification.

I think that was alluded to this morning in the ITC testimony. There are also problems of how to annualize the expenditures or sales. We had to make certain assumptions in terms of how you proceed with the analysis. In many cases we are talking about fairly large transactions which are conducted over many years. How do you conceptualize and measure these values to get comparability?

These problems are just an indication of the types of difficulties which come up, not only in the measurement, asking the question, interpreting the response, but also how to use that information. These are problems which we are dealing with in the interagency analysis.

Mr. WYDEN. Were you consulted in the development of this questionnaire?

Mr. SCHOEPFLE. Yes. As a matter of fact, it was a rather lengthy process developing the questionnaire.

I think it was about a year in process. We had an interagency group working together with OMB chairing. Initially, the Commerce Department took the lead in developing the questionnaire. As was pointed out this morning, the ITC was conducting a study on counter-trade, posing similar questions to the same set of respondents so the survey questions were folded together into a single survey which was conducted by the International Trade Commission.

There was an interagency process of consultation in the development of the questionnaire. Unfortunately, I think, as with all first efforts, sometimes there are imperfections but I think on the whole we have gathered some useful information.

Certainly one of the primary problems facing us in terms of doing any analysis in this area is the lack of information.

We have a series of anecdotal stories about various deals, but we are not in a position to take a comprehensive look and evaluate how important are these offsets and what industries are being affected.

I think that we will at least take that first step and conduct an analysis with the data we have received.

Mr. **Wyden**. I think that the subcommittee would find it helpful to perhaps have an example of the kind of problems that you all have been having.

Could you give us one specific example?

Mr. **Schoepfle**. I would have to check back with my staff—there are certain totals that needed verification.

Mr. **Wyden**. You have had problems with verfication?

Mr. **Schoepfle**. Yes. I think those have been resolved. There are still some questions—it's a rather intricate procedure in terms of what we at Labor are working with. For example, the data will then raise questions with the ITC who will then get back to the respondent. We do not have direct access to the responses, but we need to ask the ITC for clarification on this issue.

I share your concern expressed this morning about the validity of the data and what we are measuring and that was one of the reasons I put some emphasis on that in my testimony, that we are also very concerned about what we are measuring and if it's accurate.

Mr. **Wyden**. Do you think that the problems tend to understate the level of offsets?

Mr. **Schoepfle**. I think that in terms of reporting, it is probably a faithful presentation and response which is given. Often, however, the industries which might feel the impact of offsets are not really accounted for in the survey.

In other words, they might not even know they are impacted by an offset.

Mr. **Wyden**. You found evidence of that?

Mr. **Schoepfle**. I have not found evidence of that but I am thinking of certain subcontractors that might not be aware that a deal was cut and that there were certain offset arrangements made. This is just a hypotheses—or an observation—not based on any quantative measures as such. What I am just trying to indicate is that these are difficult to measure.

One can get an indication of what you might expect from some of these examples that have been given of offset arrangements.

Mr. **Wyden**. Do you believe that offsets do cause a shift in employment?

Mr. **Schoepfle**. They offer a potential for a shift. It depends on the type of offset and the arrangement as to the exact impact but there is a potential.

Mr. **Wyden**. F-18 sale to Canada, Mr. Schoepfle? What about that?

Mr. **Schoepfle**. What exactly would you like to know?

Mr. **Wyden**. More than 100 percent offset?

Mr. **Schoepfle**. I am not familiar with all the details of that but is there some aspect of that? I would be glad to prepare written——

Mr. **Wyden**. We are interested in looking at the employment aspects specifically.

Mr. **Schoepfle**. I have not made any employment estimates of that particular sale.

Mr. **Wyden**. How about the F-18 to Spain, Mr. Schoepfle? Has that one been looked at from an employment perspective?

Mr. **Schoepfle**. No. As a matter of fact, this exercise that we are going through at present is the first attempt to try to assess the employment impacts of military offset sales and represents the first attempt that the Department of Labor has made to try to do this.

I might point out that it is very difficult to do. In the survey, we put in there questions regarding employment, so we will get responses from the respondents in terms of their impressions as to what the employment effects are. Also, we will be attempting to quantify the sales and the offsets to get independent estimates of potential job opportunity gains and losses due to various sales and offset arrangements.

In general, it will be difficult to give precise estimates of employment, but we will try to give some indication of the magnitudes involved.

Mr. **Wyden**. But as of now this has been going on for years and we really don't know what the ramifications are from the standpoint of employment?

Mr. **Schoepfle**. I think that all we have really is a series of various arrangements that have been cited and you will occasionally get perhaps reports in newspapers about certain plant closings, but I think in general it is very difficult to get a causal link that here we have a sale with a corresponding offset that has resulted in the closing of a plant in some place.

It is going to be difficult to get that direct kind of relationship. I think certainly on a more comprehensive basis using the survey data we will get some indication of the diversification and how widespread this problem is.

Mr. **Wyden**. But from an intuitive standpoint you get the feeling that there is job displacement. We are losing jobs.

Mr. **Schoepfle**. I can't say that there is a net gain or loss. I think it really depends on the situation.

Mr. **Wyden**. Why don't we go situation by situation. Based on the situations you know something about, use some concrete cases and you go with some that you know about.

Mr. **Schoepfle**. I can't give you specific examples. If you have particular cases, we could probably respond in writing to those but I am not prepared at this point to discuss them in detail. I don't have the figures with me here.

Mr. **Wyden**. We would be very interested, for example, the F-18 in Canada, the impact on the furniture industry. I am puzzled why you can't furnish us at least one or two specific concrete cases, given the fact the Department says they are serious about really looking at this problem and determining what we ought to be doing?

Mr. **Schoepfle**. We are in the process of looking at it right now. We haven't looked at the individual sales in the past because we were not involved in the negotiation and preparation of those arrangements. So, therefore, we had no responsibility in terms of providing estimates of employment impact.

For type that you are describing with its indirect offset, I am not sure that we would be able to provide for that particular individual case.

Mr. **Wyden**. What are you going to say to the Congress on October 17? You have got to report to the Congress. That is only a few days off. You are telling us you have got all these problems and you can't give us any specific factual situation because you are looking at it. How are you going to come up to meet that deadline?

Mr. SCHOEPFLE. We are working on it right now. We have a 60-day extension to complete the analysis, and I don't want to compromise or speculate without completing the analysis.

I think we have to rely on the data that we have available to us, and we will do our best to make those estimates and provide them to you when the study is completed.

Mr. WYDEN. On December 17, then, you will be able to tell us?

Mr. SCHOEPFLE. I would be in a better position at that point to give you more exact and precise information.

Mr. WYDEN. You know, again, just working backwards, my understanding is the 60-day extension was granted last Friday, for example, so it has been very recent. Have you all completed your portion at the Department?

Mr. SCHOEPFLE. The quantative analysis has yet to be performed because as I indicated there were several data problems that needed to be resolved. We have had a person at OMB working with that data for about 5 or 6 weeks, and he has been working each day on this. We are making progress.

I am confident that we will be in a position to derive the estimates. I might also point out—you asked about particular sales involving, say, the F-18. The survey is not going to be by projects. It is going to be an analysis based on standard industrial classification industries so that we will not have details on particular sales. I think this is one important factor to bring out; that in our analysis, we are going to be looking at the effects of the sales and offsets on an industrial basis, not on particular arrangements or sales.

Mr. WYDEN. Mr. Schoepfle, it is our understanding from the ITC earlier there is a problem using that kind of methodology. They looked at shoes and textiles and using the standardization approach there can be some problems. Why don't you look at specific cases?

Mr. SCHOEPFLE. Because ITC will not give us the microdata. We cannot get that information from them.

Mr. WYDEN. Why is that?

Mr. SCHOEPFLE. Because they administered the survey and reached a deal with OMB in terms of what information would be released to the agencies doing the investigations.

Mr. WYDEN. So OMB has the data but they won't give it to you?

Mr. SCHOEPFLE. OMB has been very helpful in giving us the information, but OMB and ITC had some negotiations on what data would be made available from the ITC.

Mr. WYDEN. It is pretty clear to me what is going on, Mr. Schoepfle and that is the OMB and the ITC set up a way to restrict the data and then you say they are being helpful to you.

Perhaps they are on the basis of being helpful in terms of a restriction kind of formula.

Mr. SCHOEPFLE. All I am saying is that we are doing our best with the information that is being made available to OMB and us. We don't have that type of individual transaction information available so therefore our analysis would be on an industry basis.

Mr. **Wyden**. Assuming the data showed a loss in civilian employment, what could the department do, Mr. Schoepfle, to mitigate the impasse?

Mr. **Schoepfle**. It would depend upon what industry and which geographic location was involved, but I would think that in terms of adjustment assistance programs this would is one of the areas where the department has a major interest in facilitating adjustment. But this depends on the type of situation the labor market involved, and the industry involved. Each might call upon alternative proposals.

But again I am not sure that we would have the ability to identify the impact with precision on a geographic area or a particular industry. However, I can't say at this point because the analysis is not complete.

Mr. **Wyden**. Mr. Schoepfle, let me just state speaking just for myself, I am very skeptical of the kind of methodology that you are talking about. I think you have got to get into specific concrete cases to make an appraisal.

As you know, the Congress is expecting hard data about exactly what is going on there. I offer it up as just one Member's perception of what it is we really need and tell you very explicitly that I think we do need these case by case analyses. I would like to recognize minority counsel.

Mr. **Smith**. Thank you, Mr. Chairman.

Mr. Richards, I would like to ask you a couple of questions if I could. Would you suggest any particular changes in the foreign military sales program to address the problems that your study, I assume, will perceive may be created by offsets?

Mr. **Richards**. I don't think we have a specific understanding of the effects of offsets as yet to recommend a change to the offset aspect of the foreign military sale program.

I wouldn't have any recommendations for the foreign military sale program itself, but on the effects of offsets, we may. Now, I think it should be noted that in addition to the DPA study, the U.S. Trade Representative is conducting bilateral and multilateral negotiations with our allies to try to limit some of the offsets.

I think that has to be a factor and the results of those negotiations have to be assessed to see if any impact that may be determined through our initial study could be reduced via the negotiations.

Mr. **Smith**. Do you agree with the DOD's basic policy of leaving economic consequences of offsets to the discretion of the contractors?

Mr. **Richards**. I am not sure if that is the DOD policy. I think the DOD policy is they will leave the fulfillment and the negotiation of offsets to the contractor.

The DOD policy is they will not themselves assure or guarantee the meeting of the offsets and the burden of satisfying offset requirements is on the contractor. Economic assessments—or offsets—is something I think DOD has been active in in the past several years.

They have conducted a series of studies. They have contracted for a series of studies to determine some of the economic effects and they are also participating with us in the interagency community under the Defense Production Act study.

Mr. **Smith**. How would you respond to the comments of GAO that we don't know enough about the extent of offsets and their impact, given your answer now that DOD has been monitoring the situation?

Mr. **Richards**. Well, I don't know if they have been monitoring the situation. They are participating in the study. I think I do agree with the General Accounting Office that we don't know enough. The data available to us prior to this ITC study was only anecdotal information.

That information is presented to us by prime contractors who sometimes favor offsets and by subcontractors in the defense contracting chain who are affected and oppose offsets. Right now based on the presentations to us we have sort of a balanced view.

Some are of support, some are opposed. We hope through more systematic approach of the DPA study we will clarify this ambiguity.

Mr. **Smith**. As part of your study activity, have you been given specific examples of technology transfer problems that have resulted from offset requirements? Can you talk about it a little bit?

Mr. **Richards**. I think the Department of Commerce is on record of being concerned about technology transfer with the F-15, MOU with Japan. The former Under Secretary for International Trade, Mr. Lionel Olmer, commented to the GAO that he was concerned over the relative ease in which Japan obtained the technologies associated with the F-15 production program.

Mr. **Smith**. Are there any other specific examples you would like to cite?

Mr. **Richards**. No.

Mr. **Smith**. In your opinion as director of this particular study are massive offset requirements necessary to the economic well being or national security of countries like Japan, Australia, or Canada?

Mr. **Richards**. If the offsets enable the countries to purchase the weapons that are being provided, it is required for the national security. From an economic standpoint I don't think that they are absolutely necessary for the developed countries, no.

Mr. **Smith**. Fine. Thank you very much.

Thank you, Mr. Chairman.

Mr. **Wyden**. One other question, Mr. Richards. You said that the U.S. Trade Representative was having high level negotiations with respect to the offset issue specifically. It seems to me that is very timely because the evidence indicates that our problems are getting greater rather than smaller given the Korean situation and the Australian situation.

Could you give us the names of the individuals in the U.S.T.R. Office who are participating in these high level offset negotiations?

Mr. **Richards**. For the record, I would like to note that I said that they were participating in bilateral and multilateral negotiations. I did not indicate they were high level negotiations.

Mr. **Wyden**. That is fair, but these are specifically offset negotiations.

Mr. **Richards**. Offset discussions on agreeing to restricting the growth of offsets. I will be glad to provide for the committee the names of the individuals who we have been consulting with regarding these negotiations.

Mr. **Wyden**. That will be fine. We will leave the record open on that point.

[The information referred to was not received at the time of printing.]

Mr. **Wyden**. If you gentlemen don't have further comments, we thank you for your participation with the subcommittee and you are excused.

Mr. **Richards**. Thank you very much.

Mr. **Wyden**. Our third and final panel.

Mr. **Crossman**. If I may, I would also like to have Mr. Marvin Feuerwerger with us.

Mr. **Wyden**. We will do that momentarily and clear that up.

Dr. Crossman, Colonel Wetterhahn, we are pleased you can serve the subcommittee. It is the practice today to swear all witnesses. Do either of you gentlemen have an objection to being sworn?

Colonel **Wetterhahn**. I do not.

Mr. **Crossman**. I do not.

Mr. **Wyden**. Will your associate also be testifying?

Mr. **Crossman**. He will be available to answer questions.

Mr. **Wyden**. Why don't we also swear Mr. Feuerwerger?

[Witnesses sworn.]

Mr. **Wyden**. Gentlemen, thank you for your participation here before our subcommittee. We will make a copy of your prepared remarks a part of our hearing transcript in their entirety.

As I said to our last panel, in the interest of time, if you gentlemen could summarize your principle concerns, that will allow plenty of time for questions. You also have a right to committee rules at all times. I see it is before you. We look forward to your testimony. Why don't we begin with you, Colonel Wetterhahn?

TESTIMONY OF COL. RALPH F. WETTERHAHN, DEPUTY CHIEF OF STAFF, PROGRAMS AND RESOURCES, U.S. AIR FORCE; AND GEORGE R. CROSSMAN, DEPUTY DIRECTOR OF OPERATIONS, DEFENSE SECURITY ASSISTANCE AGENCY, DEPARTMENT OF DEFENSE, ACCOMPANIED BY MARVIN FEUERWERGER, DIRECTOR FOR POLICY PLANNING

Colonel **Wetterhahn**. Thank you, Mr. Chairman.

I am pleased to be here today and applaud the committee's interest in offsets and coproduction. The statement I have provided to you is relatively short and it outlines the involvement that the Department of the Air Force has in offsets and coproduction.

I would like to make some points about that statement and then entertain any questions that you might have. In initiation of discussions which could lead to a coproduction agreement must first be approved by the Secretary of Defense, the Assistant Secretary, International Security Affairs or International Security Policy, has the responsibility to insure the development and coordination of the DOD position with respect to the specific coproduction effort being contemplated and to conduct specific negotiations leading to an international agreement or delegate authority to the appropriate DOD component. DOD affects coordination and approval with State, Treasury, Commerce, Congress and others as necessary.

Very briefly the steps we take in going through this process includes securing from the Department of Defense and State, a letter of request. A letter of request is the request for the country involved for the item under discussion. We identify and resolve questions relating to the national disclosure policy.

That includes classified documents that might be involved with the country in question. We develope data and submit it to the Defense Security Agency and that information is sent forward for congressional notification involving all those major defense sales.

We prepare price and availability information, that is, with respect to the cost to the customer, and we would expect delivery of those items. And we grant special conditions for the letter of offer and agreement. The letter of offer and agreement is the contract between the country and the U.S. Government. We coordinate that letter of agreement within the air staff and affected commands within the Air Force. We then obtain the Department of Defense counter signature and furnish this contract to the customer.

We prepare the program directive for foreign military sales case implementation and then we maintain case management form start to finish. That basically summarizes our involvement.

Mr. WYDEN. Colonel, we appreciate your statement and will have some questions momentarily.

[The prepared statement of Colonel Wetterhahn follows:]

DEPARTMENT OF THE AIR FORCE

PRESENTATION TO THE COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
HOUSE OF REPRESENTATIVES

SUBJECT: Coproduction/Direct Offsets in Foreign Military Sales

STATEMENT OF: COLONEL RALPH F. WETTERHAHN
Deputy Director
Directorate of International Programs
Deputy Chief of Staff
Programs and Resources
Headquarters, USAF

October 10, 1985

MR CHAIRMAN AND MEMBERS OF THE COMMITTEE:

It is my intent to discuss how the United States Air Force implements its responsibilities under an approved Department of Defense coproduction program.

Initiation of discussions which could lead to a coproduction agreement must first be approved by the Secretary of Defense. The Assistant Secretary, International Security Affairs, or International Security Policy, has the responsibility to insure the development and coordination of the DOD position with respect to the specific coproduction effort being contemplated, and to conduct specific negotiations leading to an international agreement or delegate authority to the appropriate DOD component. DOD affects coordination and approval with State, Treasury, Commerce, Congress and others as necessary.

When completed, agreements are formalized in Memoranda of Agreements (MOAs), Memoranda of Understandings (MOUs) or directly in Letters of Offer and Acceptance. These agreements delineate specific responsibilities for the respective military departments, the foreign government and the prime contractor.

Coproduction programs have been initiated under a variety of circumstances including foreign government requests, DOD initiated discussions, and contractor sales efforts. USAF experience is that there is not a set pattern of procedures established which cover all circumstances relating to coproduction programs. However, it is important to emphasize that there are established procedures which require Department of Defense approval before military services can proceed with detailed discussions or commitments for coproduction.

When authorized by DOD to proceed with planning and implementation of a Foreign Military Sales (FMS) case which involves coproduction activation, the USAF will utilize its standard FMS procedures for a major weapons systems sale. These are:

1. Secure approval from DOD and State of the Letter of Request (LOR).

2. Identify and resolve questions relating to exceptions to National Disclosure Policy (NDP).

3. Develop the data and submit to DSAA the information for congressional notification.

4. Prepare Price and Availability (P&A) information and draft special conditions for the Letter of Offer and Agreement (LOA).

5. Coordinate the LOA within the Air Staff and the affected MAJCOMs.

6. Obtain DOD countersignature and furnish the LOA to the customer.

7. Prepare the program directive for FMS case implementation upon receipt of an accepted LOA.

8. Maintain case management responsibility until the case has been completed.

USAF experience is that once a coproduction program is established, it tends to follow a predictable pattern as the country concerned develops its industrial capability. In the initial phase there is a country to country agreement for an FMS case which at the coproduction level might involve very basic industrial capability such as system assembly. As experience is gained the program will move toward in-country manufacture of some components and assembly. This phase is characterized by both direct commercial licensing and FMS agreements. Finally, capability for complete production is achieved with a direct contractor to foreign Government relationship. To a limited extent FMS management for follow-on support to the weapon system continues.

With respect to direct offsets, the USAF complies with the DOD policy which is: "It is DOD policy not to enter into government-to-government offset arrangements because of the inherent difficulties in negotiating and implementing such arrangements. Any foreign government requesting offsets should be informed that the responsibility for negotiating any offset arrangement resides with the US contractor involved. The US Government will not commit a US contractor to an offset commitment without having its prior concurrence."

The United States Air Force addresses coproduction proposals in accordance with DOD guidelines and regulations. Generally, as much flexibility as possible is desired, recognizing that each case is unique in terms of military, political, and economic considerations. Normally, coproduction is generally preferrable to no sale at all if our national security objectives and requirements are considered and satisfactorily addressed. With respect to offsets we recognize that this is an element for consideration when dealing in the international arena. Nevertheless, the Air Force complies with the DOD policy on offsets, which places responsibility for any agreement dealing directly with offsets on the prime contractor.

JAPAN F-15

In June 1978, DOD/Japan Defense Agency (JDA) signed a Memorandum of Understanding (MOU) for the FMS purchase of 14 F-15 aircraft and 86 aircraft to be licensed produced. In December 1984, both agencies signed a revised MOU increasing the total number of aircraft from 100 to 155. Congressional Notification on 27 July 1984 permitted JDA the option of purchasing seven aircraft through FMS or all of the additional 55 aircraft through licensed production. JDA intends to license produce all 55 aircraft. The revised MOU specifically states the Japanese industry is "...not to further disclose or use such technical data, information, and documentation for any purpose other than the production purpose of this MOU without the prior written approval of the USG." Japan licensed production requires direct licenses with US contractors, no third country transfers are involved and Japanese manufactured components are not to be exported to the US. There are no known offsets involved with this license production program.

KOREA F-16

The Republic of Korea Air Force (ROKAF) requested 30 F-16A and six F-16B aircraft with support equipment, spare parts, training, and technical assistance through FMS channels on 24 May 1980. The Letter of Offer and Acceptance (LOA) was signed by the ROKAF on 1 December 1981 and amended to reflect 30 F-16C and six F-16D aircraft at ROKAF request. The first deliveries begin April 1986. There is no coproduction associated with this FMS program. Any offset agreements associated with this program were accomplished by General Dynamics and the republic of Korea and are not part of any portion of the LOA. Total cost of the LOA is $931M.

TURKEY F-16

The Turkish sale covers 160 F-16C/D aircraft and all associated support including avionics intermediate stations, ground support equipment, spares, spare engines, flight and maintenance trainers, flight and maintenance training, technical services, publications, aircraft delivery services and program management. Aircraft cost, $3.422 billion, support, $778 million. The program incorporates but does not guarantee a Turkish Industrial Participation program. The funding of the program is arranged so that FMS credits and grant aid are used only on material and labor in the United States. Turkish funds are used for all material and labor within Turkey and the excess of Turkish funds applied to United States material and labor. The pricing in the LOA recognizes that Turkish industry will be involved in production of the airframe, engines, and some avionics components. The tasks are outlined below:

Airframe: (Gen Dynamics)	Mating and Delivery	152 Aircraft
	Manufacture Aft Fuselage	112 Units
	Manufacture Center Fuselage	100 Units
	Manufacture Wing Sets	88 Units
F110 Engine (Gen Electric)	Assembly Inspection & Test	159 Engines
	Manufacture selected parts (yet to be determined)	173 Ship sets
	Manufacture of Assembly and Inspection Tools and Selected Support Equipment	
APG-68 Radar (Westinghouse)	Manufacture Dual Mode Transmitter and Programmable Signal Processor Subassemblies	160 Ships sets
Inertial Nav Sys (Litton)	Final Assembly and System Test	120 Ships sets
	Assembly and Test of Card Assemblies	93 Ships sets
	Platform Assembly and Test	45 Ships sets

ISRAEL F-16

On 15 August 1978 a Letter of Offer and Acceptance (LOA) was accepted by Israel to purchase 40 F-16A/B aircraft for an estimated total cost of $758,804,240. The LOA was changed 15 September 1978 to include a total of 75 F16A/B aircraft at an estimated total cost of $1,134,277,850. No offset agreements were established for this case. On 19 August 1983 a system case was signed between the USG and Israel for 75 F-16C/D aircraft at an estimated total cost of $2,238,690,927. As stated in the LCA "The USG will have no responsibility for any private offset for coproduction arrangements with contractors". However, offsets/coproduction agreements between Israel and contractors do exist and impact on the program. Contractors include General Dynamics, Westinghouse, Singer-Kearfott, Astronautics and General Electric.

ISRAEL F-15

The F-15 program for Israel provides for a total of 51 aircraft, acquired under three Letters of Offer and Agreements (LOAs). Initiated in 1976, the original program cost was estimated to be $1.5B. Although there are no offset/coproduction agreements included in the LOAs, the Government of Israel does provide certain items of government furnished equipment (GFE). Included in this catagory are: Inboard and centerline pylons, MAU 12 bomb racks, AIM-7 launchers, UHF radios and control panels, 600 gallon fuel tanks and other associated equipment.

EPG F-16

The Memorandum of Understanding (MOU) between the US and the European Participating Governments (EPG) (Belgium, Denmark, The Netherlands, and Norway) was signed in 1975, prior to the current DOD policy and made an offset commitment of 58% on the procurement value of the initial 348 F-16 aircraft buy by the EPG. Also a commitment for 15% offset to the EPG on all third country sales was made. Third country FMS coproduction is expected to continue indefinitely. The EPG/US contract was $2.8 billion.

Mr. WYDEN. Dr. Crossman.

STATEMENT OF GEORGE R. CROSSMAN

Mr. CROSSMAN. Thank you, Mr. Chairman.

I am pleased to be here to explain the policies of the Department of Defense which apply to the sales of the U.S. defense equipment involving offsets, in particular to the financing of such sales with Foreign Military Sales credit or MAP funds.

I think to get a complete picture of this aspect of our program we need to look at a couple of basic aspects of how we are organized in this program.

First thing that needs to be clearly understood I think is there are in fact two separate and distinct types of sales of U.S. defense equipment to foreign governments.

There is the government-to-government type arrangement that Colonel Wetterhahn just referred to, in which we conduct a negotiation and sign an agreement, a letter of offer and acceptance, which is signed by us and by them constituting an international agreement which when it is signed is then turned over to the military departments to implement and the procurement of the equipment in that agreement is done by the military procurement establishment under the Defense Department's procurement regulations, the DOD supplement to the Federal acquisition regulation, and that governs how we handle the FMS side.

The other arrangements are what we refer to as direct commercial sales between the U.S. contractor and foreign government and under the auspices of the office of munitions control in the Department of State, subject to their licensing controls.

Either of these two types of transactions of FMS or direct commercial can be financed by a foreign government's own national resources, that is as a cash transaction, or if FMS credit funds have authorized to a particular country either kind of transaction can be financed with FMS credit funds.

Either kind of transaction can have associated with it direct and/or indirect offsets. Now with that background as a structure for the kind of transactions that we are talking about I can summarize our DOD position I think fairly simply by saying that we fundamentally have two policies that apply.

The one that has been referred to already goes back to a 1978 memorandum issued by then Deputy Secretary of Defense, Mr. Duncan, which stipulates that DOD will not become involved in guaranteeing offsets.

This was a fairly significant statement. It arose out of difficulties that we found ourselves involved in when we committed ourselves to a best efforts type agreement to develop for the Swiss a 30 percent combined industry and government offset.

The Swiss considered this a firm commitment on the part of the DOD to provide business to Swiss industry which of course the DOD did not have the authority to do since we lacked the legal authority to direct contracts arbitrarily into specified Swiss industries.

Rather severe problems developed with the Swiss in terms of trying to achieve what they considered to be the terms of that agreement. The result was DOD's decision not to become involved in such agreements. That decision has been a firm policy ever since its formulation 7 years ago. We do not obligate ourselves to commitments for offset. We look to the commercial firms that are benefitting from these agreements to understand that and to fulfill those obligations.

The second policy that applies to offsets involves the use of FMS credit funds to finance sales involving direct offsets. That is, as we have said here today, offsets which are directly related to the items specified in the agreement. These offsets may be related to, as I said, government to government arrangements or foreign military sales by the DOD or to a direct commercial contract licensed by State. I think it is clear that the intent of the Congress has been that appropriated funds should be spent in the United States and for this reason the Department of Defense policy stipulates that direct offsets will not be financed with FMS funds.

We will finance only that portion of the contract which does not include these offsets. Direct offsets must be funded through the national resources of the purchser. The only exception to this policy is Israel. In fiscal year 1985 in a policy determination intended to assist Israel's industrial capability, the administration approved a $200 million level of FMS credit financing for direct offsets to Israeli industry.

A similar arrangement for fiscal year 1986 may be established. For all other countries the financing of any foreign production, components or final assembly, the item purchased must be financed using the purchasing government's own national resources. The 1978 Duncan memorandum states that we do not become involved in indirect offsets, those offsets which are notdirectly related to the item being purchased. These arrangements are negotiated separately by the purchasing government and the U.S. company. They do not appear as integral parts of the programs we are asked to finance.

Since the value of the indirect offset is not included in the contracts that are presented to us, the issue of financing indirect offsets simply doesn't arise.

[The prepared statement and attachment of Dr. Crossman follow:]

Dr. George R. Crossman
Deputy Director of Operations
Defense Security Assistance Agency

Mr. Chairman and members of the Subcommittee:

I am pleased to be here today to explain the policies of the Department of Defense which apply to sales of U.S. defense equipment involving offset, in particular to the financing of such sales with Foreign Military Sales credit or MAP funds. In order to obtain a complete picture of this area of our policy, I believe it will be useful to first describe the two basic methods used to sell U.S. defense equipment to foreign governments, and the types of financing involved in transactions involving offset.

Following approval of the sale, the most frequently used method for selling U.S. military equipment to foreign countries is by means of a government-to-government arrangement under the Foreign Military Sales program. In such an arrangement, the Department of Defense and the foreign government negotiate an agreement which specifies the terms of sale for the materiel and services to be provided. Once this agreement, which is called an FMS Letter of Offer and Acceptance, or LOA, is signed, its execution is carried out by the Military Department which is responsible for the acquisition of the items involved. The Military Department procures the required items in the same manner as it would for itself, utilizing the same general policies and procedures as those which govern its own procurement. Thus FMS procurement is basically controlled by the guidelines contained in the Defense Acquisition Regulation (DAR) Supplement to the Federal Acquisition Regulation (FAR).

Foreign governments may also purchase U.S. military equipment through direct commercial arrangements with commercial suppliers in the U.S. The U.S. Government controls this type of transaction through the munitions licensing process as authorized in the Arms Export Control Act.

Either of these two types of transactions, FMS or direct commercial sale, may be financed by a country's own national resources. For certain selected countries, FMS credit funds may also be utilized. Either type of sale may or may not involve offsets, whether direct or indirect. As was indicated earlier, the majority of military exports do not involve offsets, and those which do are limited largely to the more industrially developed countries.

There are two basic policies within the Department of Defense with respect to offset. The first of these was set forth in a 1978 memorandum by the then Deputy Secretary of Defense, Mr. Duncan. This policy stipulated that the DoD will not become involved in guaranteeing offsets. It was the result of our experience with a 1975 agreement we had reached with the Swiss Government concerning their purchase of F-5 aircraft. This agreement committed the US Government to seek to provide a 30% combined industry and government offset. Because the DoD lacked the authority to direct procurement to Swiss sources, however, it encountered great difficulty in meeting Swiss demands in connection with this agreement. The resultant DoD decision not to become involved in such agreements has remained firm policy since its formulation seven years ago. Defense does not obligate itself to satisfy commitments for offset, but rather looks to the commercial firms which are benefiting from the overseas sales to negotiate and fulfill offsets.

The second basic DoD policy with respect to offsets involves the use of FMS credit funds to finance sales involving direct offsets, i.e., offsets which are directly related to the production of the item specified in the basic sales agreement. These offsets may be related to the government-to-government arrangement for a foreign military sale by the DoD, or to a direct commercial contract licensed by the Department of State.

We believe that it is the intent of the Congress that appropriated funds should normally be spent in the United States. Therefore Department of Defense policy stipulates that direct offsets will not be financed with FMS credit funds. We will finance only that portion of the contract which does not include these offsets. Direct offsets must be funded through the national resources of the purchaser. The only exception to this policy, as a matter of course, is for Israel. During fiscal year 1985, in a policy determination intended to assist Israel's industrial capability, the Administration approved a $200 million level of FMS credit financing for direct offsets to Israeli industries. A similar arrangement for fiscal year 1986 has not yet been established. For all other countries, the financing of any foreign production of components for, or final assembly of, the item being purchased must be financed using the purchasing government's own national resources.

As I indicated in my discussion of the 1978 Duncan memorandum, the DoD does not become involved in indirect offsets, i.e. those offsets which are not directly related to the item being purchased. These arrangements are negotiated separately between the U.S. company and the purchasing government and do not appear as integral parts of the programs we are asked to finance. Since the value of indirect offsets is not included in the contracts presented, the issue of financing indirect offsets does not arise.

To summarize, Mr. Chairman, there are two basic types of military sales transactions, FMS and commercial, Either of these may be financed in whole or in part with FMS credit funds for those countries having approved credit programs. Either type of sale may have direct or indirect offsets associated with it. DoD policy provides that we will not become involved in guaranteeing offsets, and will not finance direct offsets, except, as I indicated, for a limited amount for Israel.

In your request to us, Mr. Chairman, you asked that we provide specific examples of programs containing offsets in which we have been involved. I believe the following four examples will illustrate the various combinations which may occur in this area:

1. The first is the European Consortium program for the production and acquisition of F-16 aircraft. This program involved FMS transactions, and included direct offsets. It was financed entirely by the purchasing countries' national funds; no FMS credit financing was involved.

2. The second example is the sale of the F-16 aircraft to Turkey. This involved FMS transactions, FMS credit financing, and both direct and indirect offsets. In accordance with the policies I have outlined, the direct offset portion of the sale is being financed entirely by Turkish national funds.

3. The third example comprises purchases by Israel of numerous defense items, particularly electronics systems, which involve direct commercial contracts, FMS credit financing, and direct offsets. During FY1985, 30 commercial contracts were entered into which included direct offsets.

4. My fourth example is the Japanese F-15 program, which involves a combination of FMS and commercial transactions, financing from Japanese national funds, and a significant amount of licensed production.

I will be happy to answer any additional questions relating to our policy for financing under FMS credit.

26 Sep 85

FY 1985
SECURITY ASSISTANCE PROGRAM ESTIMATED
(Dollars in Thousands)

	FMS Financing		
	Treasury	Concess.	MAP
EAST ASIA & PACIFIC:			
Brunei	-	-	-
Burma	-	-	-
Fiji	-	-	300
Indonesia	12,500	20,000	-
Korea	230,000	-	-
Malaysia	4,000	-	-
Papua-New Guinea	-	-	-
Philippines	-	15,000	25,000
Singapore	-	-	-
Solomon Islands	-	-	-
Oceanographic Res.	-	-	-
Thailand	95,000	-	5,000
Tonga	-	-	-
Regional Total	341,500	35,000	30,300
NEAR EAST & S. ASIA:			
Algeria	-	-	-
Bangladesh	-	-	-
Egypt	-	1,175,000	-
India	-	-	-
Israel	-	1,400,000	-
Jordan	42,500	47,500	-
Lebanon	-	-	-
ME Regional	-	-	-
Maldives	-	-	-
Morocco	-	8,000	40,000
Nepal	-	-	-
Oman	40,000	-	-
Pakistan	325,000	-	-
Sri Lanka	-	-	-
Tunisia	25,000	25,000	15,000
Yemen	-	-	5,000
Regional Total	432,500	2,655,500	60,000
EUROPE:			
Austria	-	-	-
Cyprus	-	-	-
Finland	-	-	-
Greece	242,000	258,000	-
Iceland	-	-	-
Portugal	55,000	-	70,000
Spain	400,000	-	-
Turkey	235,000	250,000	215,000
Yugoslavia	-	-	-
Regional Total	932,000	508,000	285,000

FY 1985
SECURITY ASSISTANCE PROGRAM ESTIMATED
(Dollars in Thousands)

	FMS Financing		
	Treasury	Concess.	MAP
AFRICA:			
AF Civic Action	-	-	5,000
African EPI	-	-	-
Benin	-	-	-
Botswana	-	5,000	4,000
Burkina	-	-	-
Burundi	-	-	-
Cameroon	-	5,000	-
Cape Verde	-	-	-
Central Afr Rep	-	-	-
Chad	-	-	5,000
Congo	-	-	-
Djibouti	-	-	2,500
Equatorial Guinea	-	-	-
Gabon	-	-	-
Gambia	-	-	-
Ghana	-	-	-
Guinea	-	-	3,000
Guinea-Bissau	-	-	-
Ivory Coast	-	-	-
Kenya	-	-	20,000
Liberia	-	-	12,000
Madagascar	-	-	2,050
Malawi	-	-	1,000
Mali	-	-	-
Mauritania	-	-	-
Mauritius	-	-	-
Mozambique	-	-	-
Niger	-	-	5,000
Nigeria	-	-	-
Rwanda	-	-	-
S. African Regl	-	-	-
Senegal	-	-	3,000
Seychelles	-	-	-
Sierra Leone	-	-	-
Somalia	-	-	33,000
Sudan	-	-	45,000
Swaziland	-	-	-
Tanzania	-	-	-
Togo	-	-	-
Uganda	-	-	-
Zaire	-	-	7,000
Zambia	-	-	-
Zimbabwe	-	-	-
Regional Total	-	10,000	147,550

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FY 1985
SECURITY ASSISTANCE PROGRAM ESTIMATED
(Dollars in Thousands)

	FMS Financing		
	Treasury	Concess.	MAP
AMERICAN REPUBLICS:			
Argentina	-	-	-
Bahamas	-	-	-
Belize	-	-	500
Bolivia	-	-	3,000
Brazil	-	-	-
Chile	-	-	-
Colombia	-	-	-
Costa Rica	-	-	11,000
Dominican Rep	-	3,000	5,000
Eastern Caribbean	-	-	5,000
Ecuador	2,000	2,000	2,000
El Salvador	-	10,000	124,750
Guatemala	-	-	-
Guyana	-	-	-
Haiti	-	-	300
Honduras	-	-	66,300
Jamaica	-	-	7,360
LAC Regional	-	-	-
Mexico	-	-	-
Panama	-	-	10,000
Paraguay	-	-	-
Peru	3,000	5,000	-
ROCAP	-	-	-
Suriname	-	-	-
Trinidad-Tobago	-	-	-
Uruguay	-	-	-
Venezuela	-	-	-
Panama Canal Area Mil Schools	-	-	-
Regional Total	5,000	20,000	235,210
NON-REGIONAL:			
General Costs	-	-	54,470
Financial Adj.	-	-	-7,430
Section 506(a) Reimbursement	-	-	-
Non-Regional Total	-		47,040
Worldwide Total	1,711,000	3,228,500*	805,100

* Of which $2,575M is forgiven for Egypt and Israel and $653.5M is loans at concessional interest rates.

Mr. **CROSSMAN**. You asked in your letter to us for some specific examples of the kinds of programs that can arise in this context. Let me conclude, Mr. Chairman, with a few examples, which I think will illustrate the spectrum of our involvement. We have had reference today to the F-16 European consortium program for production and acquisition of F-16 aircraft. This one did involve FMS transactions and did include direct offsets. It was financed entirely with European national funds; there was no credit financing involved.

We had reference today to the F-16 aircraft program in Turkey. This is a FMS program. It involves FMS credit financing, may involve MAP financing, that is anticipated, although as yet Turkey has not asked any of its MAP funds be used for that program. It involves both direct and, as far as we know, indirect offsets. In accordance with the policy that I have outlined, the direct offset portion of the Turkey F-16 program is being financed entirely by Turkish national funds, none of our credit funds will go for any of the work to be done in Turkey.

The third example is the Israeli program, in which quite a large number of Israeli contracts, all of them commercial contracts directly with United States manufacturers, particularly in the electronics area, involve FMS credit financing and direct offsets.

And, finally, we have had reference today to the Japanese F-15 program. That is entirely a FMS and commercial cash type program. There are FMS cases involved, the large commercial contract involved was solely funded with Japanese national funds, no FMS financing involved.

That gives you, I believe, a sampling of the kinds of combinations we have. I would be glad to answer any questions, Mr. Chairman.

Mr. **WYDEN**. Mr. Crossman, let us begin with you. You stated that DOD is not involved in guaranteeing an offset. Is that a correct statement?

Mr. **CROSSMAN**. The DOD policy is that the DOD will not commit itself to provide the offset. It will not undertake to contract out of its own resources to obtain a particular volume of business in a foreign government's economy.

Mr. **WYDEN**. But DOD is involved in promoting an overseas sale, providing the coproduction agreement and providing a foreign military sales credit, is that correct?

Mr. **CROSSMAN**. That is correct, we do finance, as I have just described, coproduction programs. We do negotiate coproduction programs, and where it is appropriate and desired, agree to the financing of those programs, as far as the U.S. content is concerned.

Mr. **WYDEN**. And you have stated it was the intent of the Congress that appropriated funds be spent in the United States.

Mr. **CROSSMAN**. Which is why we restrict the credit financing for those programs to U.S. sources only. The money must stay in the United States.

Mr. **WYDEN**. Now, the DOD policy only stipulates that a direct offset cannot be financed with foreign military sales credits. Why does the Department allow taxpayer financing of deals with 100 percent, even indirect offset that has been effectively bartered away?

Mr. **Crossman**. If you are thinking of the Canadian sale, I think one thing needs to be clearly understood. The Canadian program was entirely a commercial transaction. It was negotiated on the basis of an export license which approved the neogitiations——

Mr. **Wyden**. Excuse me. Does Spain receive FMS credits?

Mr. **Crossman**. The Spanish program is, to the extent the U.S. content is involved, does involve the use of FMS credit.

Mr. **Wyden**. Wasn't that another 100 percent situation?

Mr. **Crossman**. I am not familiar with the overall pattern of what they finally agreed to. I do not know what the total offset was for that program.

Mr. **Wyden**. We know that it was. And what justification is there for this kind of double benefit situation?

Mr. **Crossman**. When we are asked to approve a particular program, a country comes to us, as Spain did, and says "We are considering acquiring a new aircraft." There are a number of considerations that go into the equation as far as we are concerned.

We think the first overall consideration is, is it to the U.S. foreign policy interest and defense policy interest that that country have that item? In this case, as a NATO ally, the use of a U.S. aircraft standard to our own aircraft in the European Theater we believe was beneficial. We agreed the sale should be made.

Once we have made that decision, then the question becomes, what are the terms and conditions that you can agree to? What we do is take a sales proposal of that nature and carefully screen it. When the country has said the only way we can do this is if—the only way we can get parliamentary approval to do this is if we can, in fact, produce a portion of that item in our own industry, we then screen the thing from two points of view.

The first question is, what is the technology transfer involvement? Are there items in this aircraft that we do not wish to have manufactured abroad? Those quetions are very seriously addressed by our own technology control people and restrictions are in all cases set down in very strict form. There are items which we simply will not allow foreign industry to manufacture.

The second question is, even if the technology transfer issue is not involved, is there a defense mobilization base issue involved? Do we have a concern that if we allow this manufacturing process to go abroad, it will have an impact on those areas of the economy which defense has said are of concern to us? Quite frequently, you will get a negative decision on that basis. This occurs with great regularity. We get back from the military departments or from our own people an objection to a particular proposal, saying we cannot agree to let that piece of the proposal go to foreign industry.

Once we have done that, then we have what we consider to be as much information as we have access to. And the question is, can we then go ahead? One very important input to that whole equation is what the U.S. contractor wishes to do. If the U.S. contractors are agreeable and we are agreeable, then we will proceed.

Mr. **Wyden**. But it all comes back, in my view, to the fact that the Department is only interested in the direct offset concept. And the subcommittee hasn't seen any expression of interest in the indirect offset. It seems to me, again, that other nations are getting the double benefit from our defense sales, they receive both economic expansion of our indirect offset obligation and the benefit of U.S. taxpayer financing of the sale as well.

We have given you examples of 100 percent indirect offset sales where you get the foreign military sales credit. Spain was just one example. You stated the Congress wants taxpayer financing to be spent in the United States, but it seems to me pretty clear that you are violating this intent when you have FMS financing that deals with 100 percent in direct offsets.

Mr. CROSSMAN. Our view is that it is very, very difficult for the U.S. Government to get that far into the private board rooms of U.S. industry to make these kinds of economic balancing judgments. If the industry that is involved in a particular program believes that these kinds of agreements are necessary in order to obtain the larger benefit, as they view it, of getting the sale, it is very difficult for someone in government to second guess that. We have had this problem for a long time. We take a very serious view of it.

But the fact of the matter is that what you are involved in is kind of a poker game, particularly as is almost always the case nowadays, you have serious foreign competition in these areas. You get—you have to stare the guy across the table as government-to-government and as industry-to-industry and decide if you won't give him what he asks for, will he in fact decide that he cannot go ahead with the deal? And if you believe that the package as it currently stands is better than no package at all, then the net balance is positive. But it is a judgment call, you can't prove it. You can never prove it.

You can analyze quite precisely in most cases what the shift of jobs in the economy is as a result of what has been agreed to, but you cannot really prove that if you hadn't agreed to that the net effect wouldn't have been no business at all. Everybody tries to call that shot as accurately as he can. But it is, as I said, a game of poker. It is who blinks first.

Mr. WYDEN. But is there a danger that the contractors are, in effect, determining what is good for our own economic interests in this country? You said we don't want to get into the corporate board rooms. Well, we are already there from the standpoint of taxpayer financing.

Mr. CROSSMAN. We are assisting the program, no question about it. In many ways we are involved. Their judgment is an important factor and position. The answer is not that they make the decision, and we are a passive player, but the reverse is also not valid, in my judgment. We can't make decisions solely in government, we have to take their views into account. And I think in the economic arena, their views should be allowed to play a fairly significant role.

Mr. WYDEN. I think perhaps this is where you and I differ, Dr. Crossman. I very much want the contractors' views taken into account, they have great expertise. I think we make a great mistake if their views are the only views taken into account, and that is the mistake the Department makes by not being willing to get into the indirect offset concept.

Now, one other area I wanted to ask about. Didn't the Defense Policy Advisory Commission on Trade issue a report in December

1983 that stated, where possible, the Government should preclude offsets where U.S. grants, aids or foreign military sales credits are used?

Mr. Crossman. I am not familiar with the details of that report, Mr. Chairman, I am sorry.

Mr. Wyden. The answer is yes. We would be interested in some examples where the DSAA has precluded such sales with direct and indirect offsets. Can you give us any examples?

Mr. Crossman. Of where we have disapproved a sale based on the offset content?

Mr. Wyden. Yes.

Mr. Crossman. No, sir. I don't believe there is such a case. We did get reference, however, a little earlier to I think an important example of what happens, when the Dutch decided to buy the German tank rather than our tank, what you had was an example of where we weren't perhaps as imaginative and as forthcoming as we might have been, and it is an extremely difficult question to try to examine.

Would the United States have been better off if we had been able and willing to add a little more to the U.S. mix that was being proposed to the Dutch? Would we—did we, in fact, lose rather than gain by not being forthcoming enough with offset offers in both the industrial and governmetnal side on that particular competition? That is the case where we made our call, and we lost the poker game.

Mr. Wyden. Isn't the converse true as well, aren't there some transactions we should have walked away from that aren't in our economic interest?

Mr. Crossman. Every transaction that we have agreed to is, by definition in our judgment, one that we thought was a net benefit to the United States. It would not have been agreed to had it not been so.

Mr. Wyden. That is from an economic standpoint?

Mr. Crossman. From as broad a standpoint as we are able, and with any kind of reliability and confidence, factors into the equation as we see it.

Mr. Wyden. I read to you from the Defense Policy Advisory Committee report where it says the Government should preclude offsets where the grants in aids and foreign military sales are used, and we can also give you a copy. And you said that you knew of no examples either for direct or indirect. So if there are no examples, how is the Government precluding offsets where the grants and the aids or foreign military sales credits are involved?

Mr. Crossman. I understand your question, Mr. Chairman, to be, are there any cases in which we have disapproved a sale because we felt that to much offset was involved? The answer is, to my knowledge, no, we have not made any such decisions. We have, on occasion, been unwilling to agree to all of the offset that was being asked for and as a result lost the sale. That is a different question. We didn't make the decision, they did.

Mr. Wyden. Are you talking about direct or indirect offsets?

Mr. Crossman. In the case of the Dutch negotiation, it was a combination, as far as I know, of both what Chrysler, who had the tank facility at the time, was willing to do and what we as the DOD were willing to do.

Mr. WYDEN. We would be very interested in seeing these assessments. Could you furnish for the record, these various situations where the offset issue was involved? Is there any problem with your doing that? We want to see if you are complying with your own policy. There is nothing very complicated about it.

That is the position of the Defense Policy Advisory Committee on Trade. And yet, based on these answers over the last few minutes, I don't see any evidence that you all are following the policy, so we would like to be able to take a look, for example, at the F-18 in Spain, Australia and Canada; and the F-16 in Turkey, Greece, Korea, Israel, to make assessments of these to see if you all are following your own policy.

Mr. CROSSMAN. First of all, the Defense Policy Advisory Committee on Trade does not make defense policy, they make recommendations to the Secretary of Defense. The policies that apply in this are the two policies that I have just outlined. It is rather difficult to give examples of the application of the Duncan memorandum simply because the issue doesn't arise. Everybody knows we don't do it.

Mr. WYDEN. You said you did the analyses, and we would like to see them.

Mr. CROSSMAN. The policy that I can illustrate is the second one that I mentioned, which says that we will limit our credit financing to U.S. sources, and the Turkey agreement is a case in point, where the agreement specifically states that all of the work to be done in Turkey will be financed with the Turkish national funds. The U.S. funds will be limited to U.S. sources.

Mr. WYDEN. Is there any problem in the Department furnishing us what I asked for, which was the analyses of the F-18, particularly in Spain, where financing was involved, and the F-16 in Turkey, Greece, Korea and Israel, where there was financing involved?

Mr. CROSSMAN. I wouldn't know what to provide, Mr. Chairman. I don't understand what analyses there might be that could answer your question.

Mr. WYDEN. You just told us you were doing offset analyses. That is what we would like, those particular transactions.

Mr. CROSSMAN. I am sorry, there must have been a misunderstanding. It was not my intention to say that.

Mr. WYDEN. So, then, you don't analyze the impact of these offsets? Either you do or you don't. First you told me you did. Then we have asked for them. Now you tell me you don't. I need to have this cleared up for the record.

Mr. CROSSMAN. What we do is take a co-production proposal when it comes to us, we ask the technology transfer community if they have any objections. We ask the industrial resource people if they have any objections. On occasion, we do get back objections, stipulations and limitations.

Mr. WYDEN. That is what we want. Can those be furnished to us?

Mr. CROSSMAN. Let me see what we have in the files still, if we do, that illustrate that. We will see what we can provide.

[Testimony resumes on p. 420.]

[The following documents were received:]

AMBASSADE VAN HET KONINKRIJK DER NEDERLANDEN

ROYAL NETHERLANDS
EMBASSY
BUREAU ARMY ATTACHE

No. M-3-502/14a Washington, D.C. July 18, 1984

Defense Security Assistance Agency
Room 4B 659
The Pentagon
Washington, D.C. 20301

Dear sir,

Reference is made to your letter, dated Jan. 11, 1984, number 1-017224/83.

Please be advised that we received the enclosed letter from Col.Th.Roes, RNLArmy, in order to forward it to your office.

Sincerely,

For the Army Attache

T.P.Veenendaal
Major, RNLArmy.

Ministerie van Defensie

Directie Materieel Koninklijke Landmacht
Afdeling/Sectie Sie/PBA

Postbus 90701
2509 LS 's-Gravenhage

Telefoon 070-735735
Telex nr. 31347 KL/GV/NL

Director Defense Security
Assistance Agency
Room 4B 659
The Pentagon, WASHINGTON DC 20301
USA

Uw brief	Uw kenmerk	Ons nummer	Datum
		PBA/85.330/I	

Onderwerp
Modification M114

References: a. Letter Col. Roes 5 December 1983 nr. M-3-502/10.
b. Letter DSAA 11 January 1984.

Dear Sir,

1. As stated in my letter (ref. a) the participation of the Netherlands industry in the M114 modification program to the maximum possible extent is essential.

2. Since the so called "Stratton Amendment" prevents production of the breechmechanism in the Netherlands a non US-origin cannon will be used.

3. A second prototype is being build using a guntube produced by Bofors (Sweden).
Testing will start at the end of this year.

4. A final decision for the production of the series will be made as soon as the testresults are evaluated.

5. I do appreciate your efforts to reach an agreement as proposed by me which, I still believe, would have been to the mutual benefit of our countries.

Sincerely

For the Director Materiel RNLArmy
Project Manager Artilley Systems

Theo J. Roes
Colonel RNLA

Bijlagen
-

Bezoekadres:
Van der Burchlaan 31

Doorkiesnummer
070-731842

DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON D C 20301

11 Jan 1984

In reply refer to:
I-017224/83

Major T.P. Veenendaal
Bureau, Army Attache
Royal Netherlands Embassy
4200 Linnean Avenue, N.W.
Washington, D.C. 20008

Dear Major Veenendaal:

This is in response to the letter of 5 December 1983 received from Colonel Roes, reference number M-3-502/10, regarding the proposed M114 howitzer modification program by the Royal Netherlands Army.

Would you please convey to Colonel Roes that we have made every effort to accommodate his interests. However, as previously stated, the U.S. Government would concur with an upgrade program utilizing an M185 cannon only if it were procured in its entirety from the U.S. under foreign military sales procedures. As you are well aware, we continue to have a production base problem at Watervliet Arsenal and are making every effort to ensure that foreign requirements for thick walled cannons are directed to that facility. With respect to future third country sales of an upgraded howitzer produced in the Netherlands, we will evaluate specific requests on a case-by-case basis. This is the generally accepted manner in which such requests are handled. We have received a draft Memorandum of Understanding (MOU) from the Department of the Army for the proposed program and will be reviewing it in the near future. I hope that this has clarified the U.S. position. We will make every effort to work as expeditiously as possible.

Sincerely,

[illegible]
Director
Defense Security Assistance Agency

DEFENSE SECURITY ASSISTANCE AGENCY
WASHINGTON DC 20301 - 2800

17 DEC 1984
In reply refer to:
I-17905/84

Rear Admiral R.P. Breivik, RNON
Defense Naval Attache
Royal Norwegian Embassy
2720 34th Street, N.W.
Washington, D.C. 20008

Dear Admiral Breivik:

This is in response to your letters dated 15 November and 22 October 1984, file numbers KBH/rsb and KBN/rsb 3215/84/B/730.11 regarding authority to manufacture parts for M109 Howitzers for Germany.

We have carefully reviewed your proposal regarding production of M109 Howitzer components for sale to the Federal Republic of Germany (FRG), and have determined that these items are available from U.S. commercial sources.

On this basis, we are unable to agree to production of the M109 Howitzer components, indentified in the Annex to your letter, by the Kongsberg Vaapenfabrikk A/S Company.

Sincerely,

Philip C. Gast

PHILIP C. GAST
LIEUTENANT GENERAL, USAF
DIRECTOR

BEST COPY AVAILABLE

AL NORWEGIAN EMBASSY
ce of the Defense Attaché
20 34th Street, N.W.
ashington, D.C. 20008
Telephone (202) 333-6000
Telex Western Union 892374

Our reference KBH/rsb

Date 15 November 1984

Prev reference Our letter dated 10.22.84

Lt.Commander M. Armintrout
Defense Security Assistance Agency
Room 4B659
The Pentagon
Washington, D.C. 20301.

Dear Commander Armintrout,

Reference is made to my letter of 22 October 1984 where authority was requested to obtain Technical Data Package (TDP) for a series of items which are required in the conversion of the HOWITZER selfpropelled 155mm M 109 to the M 109 A3.

Unfortunately the items were listed with wrong part numbers. The correct numbers are as follows:

- Lock Assembly Gun Travel,	No.120.121.09 NSN 2540-01-073-4076
- Torson Bars	No.1089-8194-1 NSN 2530-01-083-5619
	No.1089-8193-1 NSN 2530-01-088-1686
	No.1089.8191-2 NSN 2530-00-008-8822
	No.1089.8191-1 NSN 2530-00-008-8821
- Propellant Stow	No.120.124.55-1 No NSN
- Latch Assembly	No.121.121.42 NSN 1025-01-056-5334
- Bustle Assemply	No.120.124.75 NSN 2590-01-149-0645
- Cover Panoramic Telescope	No.116.357.52 NSN 1025-00-493-9062

I apologize for the inconvenience this may have brought you and hope that the correct part numbers will make it possibl to the have TDP's cleared to meet a German requirement and a possible Norwegian requirement in the future.

Sincerely yours,

Roy Breivik
Roy P.Breivik
Rear Admiral RNoN
Defense and Naval Attaché

ROYAL NORWEGIAN EMBASSY
Office of the Defense Attaché
2720 34th Street, N.W.
Washington, D.C. 20008
Telephone (202) 333-6000
Telex Western Union 892374

Our reference KBH/rsb
3215/84/B/730.11
Pr reference

Date 22 October 198

Lieutenant General Philip C. Gast
Director
Defense Security Assistance Agency
Room 4E841
The Pentagon
Washington, D.C.

Dear General Gast,

This is to advice you that the Norwegian Government owned company, Kongsberg Vaapenfabrikk A/S has been requested by the German Government to bid on manufacturing of the following materiel:

- Travel Lock Safety Devise, No.441,432,220
- Torson Bars, no. 441,432,150
- Propellant Stow, no.120,124,55
- Parts Cab Door, no.120,121,42
- Bustle Assembly, no.120,121,51

Authority is hereby requested to obtain Technical Data Package (TDP) for these items which are required in the conversion of the HOWITZER selfpropelled 155mm M 109 to the M 109 A3.

Authority is also requested to manufacture these items in quantities for sale to the Government of Germany.

May we ask that this matter be given an expeditious action as bids on production of these parts are due in Germany by 31 October 1984.

Sincerely yours,
Roy Breivik
Roy P.Breivik
Rear Admiral RNoN
Defense and Naval Attaché

c.c. Mr. Edward W. Dunn, U.S. Army Materiel Command
U. S. Army Security Assistance Center
5001 Eisenhower Avenue, Alexandria, Va. 22333-0001

Enclosure

DEFENSE SECURITY ASSISTANCE AGENCY
WASHINGTON D.C. 20301

9 February 1984
In reply refer to:
I-000827/84

Major T.P. Veenendaal
Bureau, Army Attache
Royal Netherlands Embassy
4200 Linnean Avenue, N.W.
Washington, D.C. 20008

Dear Major Veenendaal:

This is in response to your letter of 25 January 1984, reference number M-4-505/1a, regarding a potential third party transfer of two breech mechanisms to the Government of Italy. Because of our production base situation at Watervliet Arsenal and the current legislation regarding thick walled cannons, we are unable to assist the foreign manufacture for third country requirements of these cannons, including their components, by consenting to such production for a third country sale. We realize that this has caused a significant problem to your government and to RDM, but regrettably we have no other course of action.

Sincerely,

Glenn A. Rudd

GLENN A. RUDD
ACTING DIRECTOR

AMBASSADE VAN HET KONINKRIJK DER NEDERLANDEN

**ROYAL NETHERLANDS
EMBASSY**
BUREAU ARMY ATTACHE

No. M-4-505/1a

Washington, D.C. Jan. 25, 1984

Director
Defense Security Assistant Agency.
The Pentagon, Room 4 B 659
Washington, D.C. 20301

Dear sir,

Reference is made to the General Arrangements concerning the coproduction of the M109 Vehicle Systems.

Please find attached a request from Colonel Roes (RNLArmy) concerning a possible third coutry sale, to which I would like te refer.
Thanking you in advance for your cooperation,
I remain,

Sincerely,

For the Army Attache

TPVeenendaal

T.P.Veenendaal
Major,RNLArmy.

I-60527/84

c.c. 1. DRSAC-MP
(mr. Robinson)
2. DMKL/PBA
(ref. PBA/82.827/A)

MINISTERIE VAN DEFENSIE
DIRECTIE MATERIEEL KONINKLIJKE LANDMACHT
CORRESPONDENTIE - ADRES: POSTBUS 90701, 2509 LS 's-GRAVENHAGE

Afdeling / Sectie: PROJECTBUREAU ARTILLERIE
Van der Burchlaan 31
Telefoon: 070 - 731842

Men wordt verzocht bij beantwoording datum nummer van deze brief nauwkeurig te vermeld

Aan

bijlagen:

uw brief van | uw kenmerk | ons nummer

onderwerp: 's-Gravenhage,

1. The Netherlands factory RDM has received a request for proposal for two breech mechanisms M109A2. These mechanisms are to be used by the Italian Army for the conversion of M109 G howitzers to M109A2 howitzers.

2. According to the Third Supplement to the General Arrangements with regard to coproduction of M109A2 dated 14 April 1979 I ask permission on behalf of RDM to produce the two breech mechanisms in case of an order.

I would appreciate being informed about the royalty fee which has to be paid by RDM.

DE DIRECTEUR MATERIEEL KL
voor deze
HOOFD VAN HET PROJECTBUREAU ARTILLERIE

Ir. Th. Roes
Kolonel van de Technische Staf

DALO-SAC (23 Feb 1982) 1st Ind
SUBJECT: TDP Requests for Launcher, Grenade M203 and Ribbon Bridge - Australia

HQDA(DALO-SAC), WASH DC 20310 25 [illegible] 1982

TO: Cdr, USASAC, ATTN: DRSAC-MA/PA, 5001 Eisenhower Ave, Alexandria, VA 22333

Based upon critical production base considerations, DA concurs with your proposal to deny provision of P&R data to Australia on the basis that a subsequent request to provide the TDPs would not be approved.

FOR THE DEPUTY CHIEF OF STAFF FOR LOGISTICS:

All incl wd

SIGNED
STANLEY DE GROOTE
Chief
Program Coordination Division

DEPARTMENT OF THE ARMY
USA SECURITY ASSISTANCE CENTER
5001 EISENHOWER AVENUE
ALEXANDRIA, VA 22333

23 FEB 1982

DRSAC-MA/PA

SUBJECT: TDP Requests for Launcher, Grenade M203 and Ribbon Bridge - Australia

THRU: HQDA (DALO-SAC)
WASHDC 20301

TO: SECDEF (DSAA-TS-B)
WASHDC 20301

1. Attached as inclosures is the documentation indicating disapproval of subject requests.

2. Request your concurrence or comments.

3. Disapproval by this Headquarters is based on problems critical to the U.S. production base.

4. Point of contact is Ms. Jefferson, DRSAC-MA/PA, AV 284-8173.

FOR THE COMMANDER:

Orest Kaczmarskyj

OREST KACZMARSKYJ
Major, GS
Chief, Pacific Division

2 Incls
as

ROUTINE

R6CF5/255591/C15A - DT: C15/0003

ACT 2

----DS-SAC-SM-RE-UA-NC-~~PT~~-OP-SANG-CP-PT-XMM-DM-IS-SS-SF-XAM-IN-DE-LD- 4/3c -

INFO

ACT

-----ATTKE-AKI-PHOPC-CCNE-MHA-/CESVCCIV /-INSCOM-DAR-DRA-DRM-GS -SGS-BOOKS

INFO

FTTLZYUW RUCIZFP4151 0192229-UUUU--RUKLDAR.

ZNR UUUUU

R 192026Z JAN 82

FM CDR ARRCOM ROCK ISL IL //DRSAR-IL//

TO CDR USASAC ALEX VA //DRSAC-MA/PA//

BT

UNCLAS

SUBJ PLANNING AND REVIEW (P&R) REQUEST FOR FMS CASE DA AT PUK

A. YOUR DRSAC-MA/PA 211639Z DEC 81 (U)

1. REF A REQ REL OF PRODUCTION TDP FOR LAUNCHER GRENADE 40MM M203 AND STATED REL OF REQ DATA HAS BEEN APPROVED.

2. NOTWITHSTANDING APPROVAL PROVIDED IN REF A, THIS COMMAND NONCONCURS IN THE RELEASE OF THE PROD TDP FOR LAUNCHER GRENADE 40MM M203 TO AUSTRALIA.

3. THE M203 IS LISTED IN THE DARCOM PRODUCTION BASE STUDY. THE BARREL FOR THE WEAPON IS CRITICAL TO THE US PRODUCTION BASE. THE PRESENT PRODUCER, COLT INDUSTRIES, IS SOLE SOURCE AND ALL FMS REQUIREMENTS ARE NECESSARY TO MAINTAIN THE WARM MOBILIZATION FACILITY.

4. IN VIEW OF INFO PROVIDED IN PARA 3 ABOVE, REQUEST SUBJ FMS CASE BE CANCELED.

BT #4151 NNNN

SECRETARY OF THE ARMY
WASHINGTON

18 APR 1980

MEMORANDUM FOR DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY

SUBJECT: Security Assistance Requests Involving 105mm, 155mm, and 8" Gun Tubes

Within the last several months the Army has individually reviewed six proposed security assistance programs for co-production which involved foreign production of gun tubes for various weapons systems.

The Army has consistently recommended against these co-production proposals for gun tubes based on the U.S. need to maintain a mobilization capability at Watervliet Arsenal for production of gun tubes.

The Army has now been asked to comment on a proposed Defense Security Assistance Agency memorandum to the Under Secretary of Defense (Policy) (at Tab A) regarding these programs. We appreciate this opportunity to provide our views.

The Army position is that authorization of any co-production of gun tubes by foreign countries at this time will further exacerbate the Army's declining capability to maintain the required mobilization base for production of gun tubes.

I have asked the Army Staff to provide your staff the recommended changes to the proposed memorandum to the Under Secretary of Defense (Policy) to support this Army position.

Clifford Alexander

Clifford L. Alexander, Jr.

1 Incl
DSAA Memo
to USDP

I-1475/80

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R1 05 041310Z MAY 83 PP UUUU 12311372

CDRUSASAC ALEX VA //DRSAC-MP/C//

DA WASHDC //DALO-SAC//

UNCLAS F O U O

SUBJ: POTENTIAL SWISS REQUIREMENTS FOR ADVANCED WEAPONS SYSTEMS

A. DALO-SAC CONF LETTER OF 13 APR 83, SAB.

1. IN RESPONSE TO REF A THE FOLLOWING IS SUBMITTED. THIS INFO WAS NOT REC'D FROM THE MRC'S IN SUFFICIENT TIME TO DEVELOP A DARCOM POSITION FOR INCLUSION IN THE PREVIOUSLY SUBMITTED INFORMATION PAPERS.

2. STINGER -

A. IT IS RECOMMENDED THAT ANY OFFER FOR BASIC STINGER BE BASED ON US POLICIES CONCERNING EXPORT OF HIGH TECHNOLOGY. THE BASIC STINGER MISSILE SYSTEM CONTAINS ADVANCED DESIGN AND MANUFACTURING TECHNOLOGY, WHICH IF EXPORTED TO SWITZERLAND, WOULD CREATE KNOWLEDGE AND TECHNOLOGY NOT NOW EXISTING THERE. THIS TECHNOLOGY IS CONFINED TO THE GUIDANCE SECTION, LAUNCH AND FLIGHT MOTORS AND THE FUZE.

B. SIGNIFICANT SWISS INDUSTRIAL PARTICIPATION CAN BE ACHIEVED, A LOGISTICS SUPPORT BASE ESTABLISHED, BUT SENSITIVE TECHNOLOGY NOT EXPORTED, BY OFFERING THE FOLLOWING FOR COPRODUCTION: LAUNCH TUBE ASSEMBLY; GRIPSTOCK; WARHEAD PARTS AND EXPLOSIVES; GAS PUMPING UNIT;

-4 MAY 1983 12 55

JAH3

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C2 C5 MAY 83 PP UUUU 12311372

BATTERY CHARGER, FIELD HANDLING TRAINER: FINAL ASSEMBLY OF THE MISSILE AND MANUFACTURE OF SELECTED COMPONENTS OF ITEMS LISTED IN PARA 2A ABOVE, AS SUBCONTRACTORS TO US MANUFACTURERS.

C. A COPRODUCTION PROGRAM BASED ON ITEMS LISTED IN PARA 2B SHOULD BE CLEARLY DEFINED IN A GOV-TO-GOV MOU WHICH ADDRESSED ISSUES SUCH AS CONFIGURATION MANAGEMENT, PHYSICAL SECURITY AND INVENTORY CONTROLS, SENSITIVE DATA, RESTRICTIONS ON THIRD PARTY TRANSFER, ROYALTY FEES, PROPRIETARY RIGHTS, ETC.

D. SWISS PARTICIPATION IN THE NATO DUAL PRODUCTION PROGRAM IS NOT RECOMMENDED FOR THE FOLLOWING REASONS: (A) THE NATO PROGRAM INCLUDES STINGER-POST (1983 - CONFIGURATION); (B) SWISS INDUSTRIAL PARTICIPATION MAY BE TO THE DETRIMENT OF NATO NATIONS WITH LESSER INDUSTRIAL CAPABILITIES I.E., TURKEY AND GREECE; (C) US-NATO MOU WOULD REQUIRE SUBSTANTIAL REVISION TO INCLUDE NON-NATO PARTICIPANTS.

3. VIPER

A. AT THE DIRECTION OF CONGRESS THE US ARMY IS EVALUATING VIPER AND OTHER AVAILABLE LAW SYSTEMS FOR FUTURE US ADOPTION. SHOULD SWISS INTEREST EXIST IN THE RESULTS OF THIS EVALUATION, A DATA EXCHANGE IS A POSSIBILITY. FUTURE US PRODUCTION OF VIPER IS DEPENDENT UPON THE

OUTCOME OF THIS EVALUATION AND UNTIL THEN MEANINGFUL COPRODUCTION DISCUSSIONS CANNOT TAKE PLACE.

B. A DECISION ON THE SHOOT-OFF RESULTS IS EXPECTED 1ST QUARTER FY 84. RECOMMEND COPRODUCTION DISCUSSIONS WITH SWITZERLAND BE DELAYED UNTIL THAT DECISION IS MADE.

4. AN/TAS-5

A. DARCOM HAS NO OBJECTION TO COPRODUCTION OF THE AN/TAS-5 BY SWITZERLAND. IT IS RECOMMENDED THAT THE EXISTING MOU BE AMENDED TO COVER THIS PROJECT AS IT CURRENTLY AUTHORIZES COPRODUCTION OF THE DRAGON (DAY) TRACKER.

B. FACTORS BEARING ON COPRODUCTION ARE:

(1) ESTABLISHMENT OF A PRODUCTION CAPABILITY FOR THE SU-108 SUBASSY CONTAINING 11 COMMON MODULES IS CONSIDERED HIGH RISK DUE TO PRODUCTION CRITICALITY AND AN EXTENDED LEARNING CURVE ASSOCIATED WITH PRODUCTION START-UP. ACCORDINGLY, PRODUCTION YIELD OF SU-108'S WITHOUT REWORK HAS BEEN LOW FOR US CONTRACTORS.

(2) SIGNIFICANT TECH ASSIST WOULD BE REQUIRED TO SUPPORT PRODUCTION OF THE SU-108 FOR WHICH PERSONNEL RESOURCES WILL NOT BE AVAILABLE AT DARCOM MSC}S. TECH ASSIST WOULD HAVE TO BE OBTAINED

FROM US CONTRACTORS ON A NON-INTERFERENCE BASIS WITH US PROGRAMS.

(3) USG MUST CONTROL PRODUCTION/DELIVERY OF SU-103'S TO INSURE SUCCESS OF OTHER APPROVED PROGRAMS WHICH ARE DEPENDENT UPON USG PRODUCTION OF SU-103'S. SHOULD THIS ITEM BE PROCURED BY GOS IN LIEU OF IN-COUNTRY MANUFACTURE, THE SWISS REQUIREMENTS SHOULD BE FULFILLED VIA FMS AS THIS PROVIDES DARCOM WITH INCREASED VISIBILITY OF CONUS PRODUCTION BASE.

(4) STATE-OF-ART RELATED TO FLIR TECHNOLOGY IS NOT RELEASABLE TO FOREIGN GOVERNMENTS EXCEPT ON A CASE-BY-CASE BASIS AS APPROVED BY DA AND/OR HIGHER HEADQUARTERS INCLUDING NATIONAL DISCLOSURE POLICY COMMITTEE (NDPC) AS A WAIVER.

C. LICENSED PRODUCTION (CONTRACTOR-TO-CONTRACTOR) IS NOT RECOMMENDED BECAUSE THE ARMY LOSES ITS ABILITY TO:

(1) EFFECTIVELY MONITOR AND CONTROL THE RELEASE TO FOREIGN GOVERNMENT/INDUSTRY OF US GOVERNMENT-OWNED TECHNICAL DATA AND RIGHTS IN THOSE DATA.

(2) INSURE THAT STIPULATIONS PROHIBITING 3RD COUNTRY SALES ARE INCORPORATED IN A GOV-TO-GOV AGREEMENT.

(3) IDENTIFY AUTHORIZED PRODUCTION QUANTITIES IN CONJUNCTION WITH THE CONVEYANCE OF PRODUCTION RIGHTS.

(4) INSURE THAT ADEQUATE TDP MATERIALS, REFLECTING ALL REQUIRED CHANGES TO DRAWINGS AND SPECIFICATIONS, ARE PROVIDED IN CASES WHERE RELEASE IS APPROVED.

(5) AFFORD THE RECIPIENT GOVERNMENT THE OPPORTUNITY TO PROCURE TDP REVISIONING SERVICES FROM THE USG.

5. USASAC POC IS RUSS BRILLHART 274-9892.

1F

002747009043/030A - DTG: 130/2118
ACT
-----DS-SAC-SM-FL-GA-EO-FP-DP-SANG-CF-PI-CO-DM-IS-SS-SF-XAM-IA-DE-LP
INFO--
ACT
-----ATTNS-ARI-CCAC-MHA-INSCOM-XSO-CE-TM-MS-DMR-DRA-DRM-GS-MT-SGS-   BOOKS
INFO--
RCTCZYUW RUCDSRA0599 1302013-CCCC--RUKLDAR.
ZNY
P 091905Z MAY 84
FM CDRMICOM REDSTONE ARSENAL AL//DRCPM-TO//
TO RUKLDAR/CDRDARCOM ALEX VA//DRCIP-P//
INFO RUKLDAR/CDRUSASAC ALEX VA//DRSAC-MP/C//
RUEOFUA/DIRNVEOL FT BELVOIR VA//DDRFEL-NV//
RUEADWD/DA WASH DC//DALO-SAC//
BT

2 1F

SUBJ: TOW 2 COMPONENT IDENTIFICATION (U)
A. MSG, DRCIP-P, USASAC, 022002 MAY 84, SAB.
B. MSG, DALO-SAC, DA, 012331Z MAY 84 (C), SAB.
C. MSG, DRCPM-TO, MICOM, 272020Z JUN 83, SUBJ: TOW 2 SYSTEM - SWITZERLAND (U)
D. MSG, DRCPM-TO, MICOM, 081530Z FEB 84 (C), SUBJ: TRANSFER OF TECHNOLOGY (U)

1. REF C PROVIDED TOW PM POSITION RELATIVE TO COPRODUCTION OF ITEM PREVIOUSLY REQUESTED BY SZ. STATEMENT INDICATING A SMALL PERCENTAGE OF COMPONENTS REQUIRE SENSITIVE MANUFACTURING TECHOLOGY APPLIES TO SOME INDIVIDUAL VENDORS. EXAMPLE, GOV'T TOP FOR MSL BATTERIES CONTAINS FORM, FIT AND PERFORMANCE SPEC. VENDOR MAY OR

PAGE 02 RUCDSRA0599
MAY NOT RELEASE HIS MANUFACTURING KNOW HOW.

2. NO OBJECTION TO COPRODUCTION OF ALL COMPONENTS LISTED IN PARA 2.A AND B OF REF B WITH EXCEPTION OF TOW 2 FLIGHT MOTOR AND AN/TAS-4A NIGHT SIGHT.

3. RATIONALE FOR STATEMENT IN PARA 2 ABV IS:

A. AN/TAS-4A - IT IS THIS PROJECT'S OPINION THAT THIS ITEM CONTAINS LATEST AND MOST ADVANCED TECHNOLOGY THE USG HAS IN TERMS OF FLIR TECHNOLOGY. HOWEVER, DETAILED TECHNOLOGY ASSESSMENT AND RELEASIBILITY STATEMENTS MUST BE OBTAINED FROM NVEOL AS THEY ARE THE PROPONENT FOR FLIR TECHNOLOGY.

B. THE TOW 2 FLIGHT MOTOR UTILIZES A MINIMUM SIGNATURE, CROSS-LINKED, DOUBLE BASE PROPELLANT.

THIS HIGH-ENERGY, SMOKELESS PROPELLANT IS UTILIZED IN A CASE-BONDABLE APPLICATION. THE TWO PERFORMANCE ADVANTAGES OF THIS TECHNOLOGY, AS COMPARED TO OTHER SMOKELESS SYSTEMS, ARE THAT A 10 PERCENT SPECIFIC IMPULSE ADVANTAGE IS TRANSLATED IN TERMS OF RANGE OR PAYLOAD, AND IN ADDITION, THE CASE BONDABILITY ASPECTS RESULTS IN

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**

LESS INERT WEIGHT AND HIGHER VOLUMETRIC LOADING, LEADING TO AN ADDITIONAL 5 - 10 PERCENT INCREASE IN RANGE OR PAYLOAD. IN SUMMATION, THE NET ADVANTAGE IN TERMS OF VELOCITY, RANGE OR PAYLOAD

IS A 15 - 20 PERCENT INCREASE. MINIMUM SMOKE ROCKET MOTORS HAVE FOUND APPLICATION TO AIR DEFENSE, ANTITANK AND HELICOPTER ARMAMENT SYSTEMS BECAUSE OF ADVANTAGES OF NOT IDENTIFYING LAUNCH SITE WITH SMOKE TRAIL, OF NOT OBSURING GUNNER'S VIEW FOR POSSIBLE SECOND SHOTS, AND OF NOT CUING THE TARGET TO EVASIVE ACTION. FUTURE APPLICATIONS INVOLVING GUIDANCE SYSTEM INTERACTIONS (AS IN CASE OF BEAM RIDERS) MAY ALSO DICTATE VERY CLEAN EXHAUST PLUMES TO PERMIT COMMUNICATION WITH MSL.

D. TOW 2 DIGITAL MISSILE GUIDANCE SET (DMGS) - TDP FOR DMGS DOES NOT INCLUDE DOCUMENTATION OF SOFTWARE LOGIC AND THEORY OF OPERATION OF TOW 2 SYSTEM. TDP CONTAINS ONLY THE "READ ONLY MEMORY (ROM)" MAPS FOR PROGRAMMING MICROPROCESSOR "ON BOARD" MEMORY AND GUIDANCE AND VIDEO THERMAL TRACKER (VTT) MEMORY BOARD. THE ROM MAPS CAN ALSO BE DUPLICATED BY READING OUT FROM DMGS HARDWARE THEREBY OBTAINING SAME RESULTS AS TDP. THIS TASK IS CONSIDERED

TO BE VERY EASILY ACCOMPLISHED. THEREFORE NO OBJECTION TO COPROD OF DMGS.

TO REVERSE ENGINEER DMGS TO OBTAIN LOGIC AND THEORY OF OPERATION SOFTWARE, FOLLOWING TASKS ALONG WITH ESTIMATED TIMES ARE PROVIDED. ASSUMPTION THAT ROM MAPS ARE AVAILABLE.

(1) CONVERT HEXIDECIMAL CONTENT OF ROM MAPS TO ASSEMBLY LANGUAGE. APPROX 6 MONTHS.

(2) DETERMINE INTERRUPT/HARDWARE PRIORITY - 3 TO 5 MONTHS.

(3) FLOW CHART ASSEMBLY LANGUAGE - 1 TO 2 YRS.

(4) DOCUMENT FLOW CHART BASED ON TESTING COMPONENTS OF FLOW CHART UTILIZING HARDWARE - 4 TO 6 YRS.

E. SENSITIVE MANUFACTURING TECHNOLOGIES AS DESCRIBED IN PARA 1 ABV ALSO APPLIES.

4. GOVT TDP FOR COMPONENTS LISTED IN REF B ARE UNCLAS.

5. SWISS MANUFACTURING TECHNOLOGY HAS CAPABILITY TO PRODUCE SYS GIVEN ASSISTANCE IN ESTABLISHING A PROD CAPABILITY. AS TO ITEMS TOO EXPENSIVE, THIS OFC IS NOT IN A POSITION TO ASSESS WHAT THE SWISS ARE WILLING TO PAY OVER AND ABV NORMAL COST OF ITEMS IN ORDER TO ESTABLISH A PROD BASE.

Mr. **Wyden**. Could you give us a recent example of what you are talking about?

Mr. **Crossman**. Not offhand, I am sorry, no, I can't.

Mr. **Wyden**. So it is obviously not very prevalent, you can't give us a specific example.

Mr. **Crossman**. We do, as I say, get objections. I simply don't have a specific example in my mind at the time that I can offer you.

Mr. **Wyden**. Dr. Crossman, the General Accounting Office stated that while Turkey may not use their foreign military sales credits to purchase Turkish parts built for the F-16, they may use the credits for tooling, license and technical data packages. Are they correct in their analysis?

Mr. **Crossman**. That is correct, sir.

Mr. **Wyden**. So the U.S. is essentially financing the creation of the Turkish aerospace industry through that arrangements.

Mr. **Crossman**. To the extent those technical data packges are of use to the Turks in that regard, yes.

Mr. **Wyden**. I don't know what else they would use them for, do you?

Mr. **Crossman**. How far they will go, how much progress they will make with the small portion of the program they are thinking about trying to do, we don't know yet.

Mr. **Wyden**. In 1985, did Turkey receive foreign military sales credits and a concessional right to reduce the rate?

Mr. **Crossman**. I believe so, yes.

Mr. **Wyden**. What rate did we charge them?

Mr. **Crossman**. I don't have those figures.

Mr. **Wyden**. It is my understanding it was about 5 percent.

Mr. **Crossman**. That may be.

Mr. **Wyden**. Not only did we finance their industry, we subsidized it as well. Is that right?

Mr. **Crossman**. You can draw that inference if you so choose.

Mr. **Wyden**. What other inference could you possibly draw?

Mr. **Crossman**. What we have done is said two things: We have said we believe it was in the U.S. interest overall to assist the Turks in their efforts to develop this aspect of their economy. We think it is to the U.S. interest that that happen. We have said that these credit funds will be spent in the United States for certain elements of that program that do, in fact, support that. The entire program is based on an agreement that some portion of that program will, in fact, involve the development of a portion of Turkish industry. Every coproduction program we have ever agreed to has that nature by definition. That is part of what the coproduction program involves.

Mr. **Wyden**. Dr. Crossman, I can only say that it is my view it is a sad state of affairs when we are financing over there the Turkish aerospace industry with 5 percent money, and I am very much committed to seeing us turn it around.

Mr. **Crossman**. Mr. Chairman, if I may, I think that one ought to take into consideration the question of whether or not a move on the part of our Government to strengthen the economy of an ally in the hopes that they will thereby be able to contribute something to our defense as well as their own and increased economic stability, increased pro-Western orientation, increased willingness to follow the United States' lead in foreign or defense policy matters isn't an important element also. None of these agreements are ever entered into without State and Defense together believing that the net answer to those questions is favorable to the U.S.

It follows, therefore, that an arbitrary judgment on the economic side may very well have overriding negative impacts in some other very important areas. We need to keep it in the broad context, I believe.

Mr. WYDEN. There we come back again, Dr. Crossman, to the analyses. And you are talking about balancing a variety of important issues, and that is why it is so important that we see your actual analyses. You talk about analyses, you know, when it comes to trying to justify policies that don't make a lot of sense to Oregonians. You talk about instability. There is a lot of economic instability in the State of Oregon right now, and citizens wonder why it is we are making subsidies around the world when there are no such practices here in the United States.

We will look forward to seeing your analyses so that we can actually make a determination of whether these decisions are the basis of sound judgment or just simply United States financing the economic development of other nations.

Mr. CROSSMAN. I don't want any misunderstanding, Mr. Chairman. I don't think there are any analyses written down on pieces of paper I will be able to provide you.

Mr. WYDEN. You just said the Department of Defense and the State Department take into consideration all these factors in making these decisions. We can't have it both ways. Either there is analysis made by the Department of Defense and the State Department, or there isn't. You made it clear there are some analyses that have been made. The subcommittee will await your furnishing documentation, and I know we will want to talk with the Department——

Mr. CROSSMAN. If it is an oral discussion with no documentation, I am afraid I can't help you very much, Mr. Chairman.

Mr. WYDEN. This just gets more and more out of the realm of the reasonable, Dr. Crossman. We are now involved in analyzing multibillion-dollar deals on an oral basis. We get a couple people together, talk a few minutes and make some oral comments, and that is how the Department of Defense and State Department are making an assessment of offsets. Is that really the way it works? You just said they are oral judgments. That is the way it works?

Mr. CROSSMAN. Someone comes to me with a proposal, they outline the program, and they ask me if on the basis of our experience and our knowledge, does our organization, one of many that work on these programs, agree? The answer is we talk about it among ourselves, we look at our background, our experience, we look at the proposal, and we either agree, or we ask that it be changed. But there isn't any written analysis of that discussion process. What you have is an initial on the proposal that says we agree to it.

Mr. WYDEN. Dr. Crossman——

Mr. CROSSMAN. I think that is the normal way of doing business in the Government most of the time.

Mr. **Wyden**. Not when $6 billion is involved. That is the kind of money we are talking about here, and that is the annual figure. You just cannot convince me that the normal way to make decisions about $6 billion of the taxpayers' money at a time of big deficits is on the basis of oral discussions. I must tell you that the decisionmaking process, as it is described to me, grows more and more absurd, and I think it is clearly not in the national interest to make decisions involving $6 billion on the basis of a few oral discussions.

Mr. **Crossman**. Mr. Chairman, I will provide you as much as we have available on the subject, and what we have in the files as best I can.

Mr. **Wyden**. I know that Chairman Dingell will await this information with great, great interest.

Colonel Wetterhahn, you testified DOD policy prevents you from entering into offset arrangements, that the policy keeps you from commiting the Government to offset commitments, is that correct?

Colonel **Wetterhahn**. That is correct.

Mr. **Wyden**. You also said you recognize offsets are an element for consideration in the international arena. Now we know you cannot be directly involved on such an obligation, but you certainly can be aware and involved with it, is that correct?

Colonel **Wetterhahn**. That is correct.

Mr. **Wyden**. Does the Air Force actively promote arms sales overseas?

Colonel **Wetterhahn**. The Air Force involvement in overseas procurement of these weapon systems that we are discussing today involves providing briefings upon request to the various countries involved. The decision to purchase a United States or a foreign system is basically left up to the country.

Mr. **Wyden**. The Secretary sends letters to foreign officials touting our systems and sends technical teams to provide briefings, middlemen on Government-to-Government sales. What we are interested in knowing is in all this involvement, does anyone in the Air Force or DOD do an economic or trade assessment of the offset obligations that are being agreed upon?

Colonel **Wetterhahn**. No, Mr. Chairman; no one in the Air Force does an economic assessment of the offsets involved, particularly indirect offsets. We have no involvement in that.

Mr. **Wyden**. So there wouldn't be any assessment on the F-16 sale to Greece or to Turkey?

Colonel **Wetterhahn**. An assessment of the offsets?

Mr. **Wyden**. Yes.

Colonel **Wetterhahn**. No; the Air Force would not have an assessment of the indirect offsets. The only assessment that we might have of direct offsets would involve how that might fit in within a production schedule of a particular aircraft.

Mr. **Wyden**. Could we have that for the record with respect to the direct offsets, the assessment you all have?

Colonel **Wetterhahn**. Have what for the record?

Mr. **Wyden**. The assessment of the direct offset. Unless I misheard your last answer. Between Turkey and Greece.

Colonel **Wetterhahn**. Between Turkey and Greece?

Mr. Wyden. Excuse me, the sale to Turkey and the sale to Greece. You said there would be an assessment of a direct offset. We would be interested in having that for the record.

Colonel Wetterhahn. The assessment of that direct offset—let me clarify what that means. The assessment would involve simply a look at how those products, direct products, the aircraft parts, wingtips, whatever, would fit within the production schedule, worldwide production schedule, of, in this instance, the F-16 aircraft. It is simply a case of looking at when downstream, 2 or 3 years from now, that aircraft is going to come off the line. It is not an assessment of the cost of the item or——

Mr. Wyden. Can you give us a copy of that assessment?

Colonel Wetterhahn. I can provide you the details of what we have determined based upon, for example, the F-16 delivery schedule to Turkey. For Greece, we don't have that because we don't have a contract with Greece.

Mr. Wyden. We will leave the record open on that point, and that is helpful.

Mr. Wyden. We would like to walk through an example of the Air Force's coproduction agreements, and specifically the EPG sale. Now the United States signed an agreement with Belgium, Denmark, the Netherlands, and Norway to coproduce the F-16. Is that right?

Colonel Wetterhahn. That is correct.

Mr. Wyden. In total, we are talking about 348 F-16's?

Colonel Wetterhahn. Yes.

Mr. Wyden. For the sale, we agreed to let them produce 40 percent to the equivalent value of the F-16 components.

Colonel Wetterhahn. That is correct.

Mr. Wyden. Exactly what does this entail? Are there European firms set up providing U.S. technology? What exactly does this involve?

Colonel Wetterhahn. That is correct. But I should point out that in these technologies that we are discussing today, the technology involves a manufacturing technology, in other words, building the part. It does not involve the design technology, the research technology, or the testing technology to develop that part in the first place. That is a very important distinction, and it applies to Japan as well as to the EPG. Therefore, the country with the design—without the design—has a difficult time taking that manufacturing technology and building a different airplane with it.

But, yes, those companies in those countries manufacture bits and pieces for the F-16. That is a correct statement.

Mr. Wyden. Now, in addition, we agreed to use European components for 10 percent of the Air Force's 600 F-16's.

Colonel Wetterhahn. That is correct.

Mr. Wyden. So, in effect, in this situation, we have got an offset commitment of 58 percent.

Colonel Wetterhahn. Well, that is correct.

Mr. Wyden. And so our economic gain was the added work of 42 percent of the 348, or approximately 146 additional units.

Colonel Wetterhahn. But you left out the 60 percent of the European participating group's aircraft that are produced within this country, so you left out a very important point there. That 60 percent would not exist if the agreement did not exist, and the competition back in the 1970's between the F-16 involved corporations outside of this country.

Mr. **Wyden**. We did include it, it is part of the added work. So it was included in that figure.

Now, the European components put into the U.S. Air Force F-16's were bought at a premium, and we paid more for those parts than General Dynamics could have sold to us from Fort Worth. Isn't that correct?

Colonel **Wetterhahn**. That is correct. But that can be offset by the increase in the efficiency due to the extension of the production line by General Dynamics. In other words, they are building 60 percent of 348 aircraft. There are some efficiencies involved in that. And the tradeoff is very difficult to determine between the two, and my best estimate would be that is probably about a wash, the difference between the two.

Mr. **Wyden**. According to General Dynamics, we essentially agree the premium paid for these parts negated the gains of the added production. General Dynamics claimed the price for the U.S. Air Force's 650 was a stand-alone price. This is—we gain nothing from a price standpoint, with the added European sale. How does the Air Force respond to that?

Colonel **Wetterhahn**. The Air Force responds to that in that there is more than economic consideration to be looked at here. We have to take a look at, first of all, the things that were mentioned earlier, the other benefits, the interoperability between U.S. forces and NATO, which in time of war is absolutely indispensable, the commonality of ammunition, fuels and all of the spare parts.

In addition, we have to look at the fact that when we enter into an agreement with these countries, we receive an enormous number of intangible benefits. The people in those countries, the pilots, the maintenance folks, come to this country, they train, they are exposed to the things that this country has to offer in terms of its democratic systems, they take those back to their countries, and we find very often that these people find their way into very high positions within the military and within the civilian sector.

All of these are intangible benefits, but certainly come into consideration when a decision is made to enter into this agreement. The alternative is very obvious. Either you have a percentage of something, or you have 100 percent of nothing. Because if they buy an aircraft from a firm outside of this country, we have none of these benefits to be gained, they go elsewhere.

Mr. **Wyden**. Who did we beat out? It was my understanding we beat out other NATO countries. You made this argument about commonality, something that we have a great interest in, and I fail to see how commonality comes about in such a situation.

Colonel **Wetterhahn**. The first part of your question, who did we beat out? We were in competition with the French and with a Swedish aircraft——

Mr. **Wyden**. NATO countries?

Colonel **Wetterhahn**. Right.

Mr. **Wyden**. How did that promote——

Mr. **Feuerwerger**. Sir, Sweden is not a member of NATO.

Mr. **Wyden**. I am sorry. The Swedes are independent, and the French are a member of NATO. Thank you very much for correcting that. Still, how did this promote NATO cooperability, commonality?

Colonel **Wetterhahn**. Because we have the F-16 within the U.S. Air Force inventory, and we have commitments to NATO in time of war.

Mr. **Wyden**. The French have all that, and we beat them out.

Colonel **Wetterhahn**. That is true, there is nothing 100 percent, Congressman. But I should point out, if several of the NATO countries had obtained the Mirage, there would be less commonality than exists today.

Mr. **Wyden**. Let's go through the rest of this situation. We agreed to give the Europeans 15 percent of all the Third World country sales, is that correct?

Colonel **Wetterhahn**. That is correct.

Mr. **Wyden**. Economically speaking, if the added production were negated by higher cost, we end up in the hole once we factor in the Third World country sales. From an economic standpoint, don't we end up in the hole under that kind of arrangement? If gains in production are negated by higher costs, then you got the Third World country sales.

Colonel **Wetterhahn**. All this goes back to the basic question if there was no sale, there would be absolutely no benefits to the economy or to all these other things I am talking to. I am not sure I understand the math involved here.

Mr.**Wyden**. I don't see the economic benefits. You have talked at some length about your belief there are noneconomic benefits involved and I went through—for example, in the last question I asked you, it is hard to see where the benefits were by beating out the French, and I would like you to describe for me some economic benefits that come about as a result of these arrangements.

Colonel **Wetterhahn**. The economic benefit is 60 percent of the 348 aircraft were produced within this country, and it took people to build those parts, to manufacture those parts, and to provide them to the Europeans.

Mr. **Wyden**. We gave that up in the premium. They are 10 percent of our 650. We gave it up.

Colonel **Wetterhahn**. I don't understand the math here, Congressman. I see 40 percent of the dollar value of the aircraft going to the European participating group, I see 10 percent of the 650 aircraft that were produced for this country going to the European participating group, and I don't understand how that comes to more than 100 percent.

Mr. **Wyden**. It is an economic wash, we spent the same amount of money. You said that yourself. We are trying to find the economic benefits, and we still have not had any described better than an economic wash, paid the same amount of money, based on what you said.

Mr. **Crossman**. May I make a comment, Mr. Chairman?

Mr. **Wyden**. Please.

Mr. **Crossman**. It may be that under certain kinds of assumptions, and we are talking strictly assumptions, because we don't know what the GD prices would have been if they hadn't had this, on certain assumptions if you were able to bring out the arithmetic to be an economic wash in terms of balance of trade consideration, you still had a great many more jobs created in the United States as a result of that program that otherwise you would not have had. Perhaps that is worth something.

Mr. **Wyden**. Let us keep going. Third World countries are paying a premium on their European parts as well. Our investigators, Colonel Wetterhahn, were told this premium runs about $600,000 per aircraft. Is that correct?

Colonel **Wetterhahn**. I believe what you are referring to there is the R&D recoupment, research and development recoupment costs? I am not certain.

Mr. **Wyden**. The premium of the 15 percent in the Turkey and Greece sale.

Colonel **Wetterhahn**. The 15-percent premium you refer to in the case of Turkey, I think, in the testimony was referred to about $600 million. The premium to the European participating group for that sale was about $240 million. It doesn't involve 15 percent of the entire $4.2 billion involved in that sale, just a portion of it. But it is $240 million. For that $240 million, the European participating group provides parts for those Turkish aircraft.

Mr. **Wyden**. Not as many parts as Fort Worth would provide for $240 million. So there is a premium.

Colonel **Wetterhahn**. In that sense, there is a premium. But, again, the alternative is to have nothing versus the situation that we have today.

Mr. **Wyden**. I don't share your views there is no alternative. The alternative is do it in Fort Worth. When you consider U.S. taxpayers have financed many of the F–16 sales at a concessional rate, our economic losses to the Europeans grow larger and larger, how would you respond to that?

Colonel **Wetterhahn**. I respond to that by saying the rates are determined by Congress, not by the Department of the Air Force.

Mr. **Wyden**. It seems to me the way the Europeans end up is they get one of the world's great front line fighters, they get U.S. technology to build it, United States and Third World countries helped to pay for the creation of the capability, they get a disproportionate share of the jobs, and we end up with standardization and interoperability. Is there anything you disagree with? It is a wonderful arrangement for them.

Colonel **Wetterhahn**. Well, Mr. Congressman, I think that is a very simplified view of how these arrangements ultimately come about or ultimately terminate. To say because we have a European participating group that the U.S. economy has lost jobs I don't believe is a valid statement in the aggregate. There are certainly some jobs lost when parts are produced in a foreign country. But offset by that are the jobs that are created by increasing the production of, in this case, the F–16 aircraft. And if in total it turns out to be a wash, again we go back to the alternative of if there were no sale in the first place, we would have in Japan and in the European participating group a competing market producing aircraft.

Let's take, for example, Japan. Is that country bent on developing an aerospace industry? If the answer to that is yes, then the next question is, will we compete and be part of that, or will we let that industry be developed by some other agency, whether it be European, or wherever? Those are the basic questions.

Mr. **Wyden**. Colonel Wetterhahn, they are not allowed to compete with us militarily, as you are aware. It is in the Constitution.

Colonel **Wetterhahn**. Are you speaking of Japan?

Mr. **Wyden**. Yes.

Colonel **Wetterhahn**. That is correct.

Mr. **Wyden**. What exactly are you talking about? You are talking about defense capabilities in Japan, they are not allowed to compete with them.

Colonel **Wetterhahn**. That is right, they have not competed in selling military aircraft to Third World countries. As has been pointed out earlier, they have been involved for 30 years in working with this country in some level of co-production for the T-33 aircraft all the way up to the F-15. What we were discussing earlier, was the transfer of that technology to commercial aircraft, I believe was the discussion.

Mr. **Wyden**. Now we are building up their civilian commercial aircraft capability this way. I mean, just a minute ago you said it was for defense reasons, we spelled out you can't do it for defense, now we are talking about building them up in a civilian way.

Colonel **Wetterhahn**. Well, you can make that inference.

Mr. **Wyden**. What other inference would you make?

Colonel **Wetterhahn**. The testimony I heard earlier referred to—the only example I heard cited was the Boeing 767 transport under license production to Japan. I would point out that is an American aircraft, and Boeing is an American corporation. So if the United States technology—again, I am talking about manufacturing technology, not design technology or research technology—was used in the development of that aircraft, I submit Japan would have used some other country's technology to do the same thing, and we would not be a part of that.

Mr. **Wyden**. You know, it just seems amazing that we have taken this approach on defense, first by promoting RSI and economics, second, while our allies seem to be concerned about economics and our technology first, and the common defense second. That is the concern of the subcommittee. And the Deputy Assistant Secretary of Defense for Policy Analysis talks specifically about the offset. He said it was also clearly in the interest of the United States to aid this process, as it bolstered the defenses of both ourselves, and our allies, improved our allies' industrial capability, and strengthened their economies.

What the hearing is all about, what the subcommittee is all about, is that we are so concerned about our allies and industrial capability, economies and defenses and just barely mentioning our own defenses. What is your appraisal?

Colonel **Wetterhahn**. I am afraid I had a little difficulty following the line of that question. Can you summarize it?

Mr. **Wyden**. Sure. I will read it right back to you. We are talking about the well-being of the allies. The Deputy Assistant Secretary of Defense stated, it was also clearly in the interest of the United States to aid this process, because it bolstered the defenses of both ourselves and our allies, improved our allies' industrial capability and strengthened their economies. What about our economies?

Colonel **WETTERHAHN**. I submit it has, in effect, strengthened our economy as well.

Mr. **FEUERWERGER**. Sir, if I may speak here, that testimony was speaking to the historical record, historical background of our support for offsets. I refer you to Dr. Blaker's testimony, page 4, I think if you read it in context, he was stating that in the post-World War II area, the United States felt very strongly it was in our interest, to support the growth of allied industries. I think that is a true statement, sir.

Mr. **WYDEN**. It certainly seems our economic well-being has been put on the back burner, and our subcommittee very much wants to turn this situation around.

Mr. **FEUERWERGER**. Sir, we disagree very strongly on that score.

Mr. **WYDEN**. Tell me how otherwise. We have heard, for example, from Dr. Crossman talking about giving away $6 billion worth of funds on the basis of oral transactions.

Mr. **FEUERWERGER**. I don't think you heard that from Dr. Crossman. The figure you cite is the agreement to engage in countertrade or indirect offsets, it is not taxpayers' money that has been given to foreign countries?

Mr. **WYDEN**. That is the amount of money involved here, and Dr. Crossman——

Mr. **FEUERWERGER**. Money involved in indirect offsets or direct offsets. It is not U.S. taxpayers' money necessarily, except insofar as that money came out of foreign military sales programs. That would be a lesser figure, for example the import figure this morning.

But in terms of our commitment to U.S. economic interests, you have had the contractor up here testifying in the last week, although we don't do the analysis, that is not our responsibility, the contractor——

Mr. **WYDEN**. Whose responsibility is it?

Mr. **FEUERWERGER**. As you have directed or at least Congressman Vento's committee has directed, the Office of Management and Budget is coordinating that study. The Defense Department is participating, but the Departments of Labor and Commerce are doing the analysis on the impact on our domestic economy.

Mr. **WYDEN**. The Commerce and Labor Departments, they were here and said they were not involved. What are you doing with this information?

Mr. **FEUERWERGER**. That is incorrect, sir, they are involved.

Mr. **WYDEN**. Were not involved in the approval of the sales?

Mr. **FEUERWERGER**. That is correct, they were not involved in the approval of these sales.

Mr. **WYDEN**. Who then looks out for the economy? That is the principal concern, the civilian American economy, who looks out for it?

Mr. **FEUERWERGER**. Take two sides of that. You said we had no interest in our economy, and basically, in the past, the way we have functioned is, if a corporation felt it was making a profit on the deal, we did not interfere in that calculus.

We have seen in the last several years a growing feeling, and now we are out gathering data, that the offset problem is a problem for the U.S. domestic economy. Today we are trying to evaluate whether it is a problem, what the scope of that problem is, exactly how that impacts upon us.

Once we have assessed that, we have a basis for policymaking to see if there is a requirement for any change in the way in which we are doing business. But the problem you point to has not been perceived in the past, at least not until quite recently, this decade, as a major problem for the U.S. domestic economy.

We are now engaged in a study to determine exactly what the scope of that problem is.

Mr. **Wyden**. Wasn't both the Department of Defense and the State Department in opposition to getting Labor and Commerce involved in this area of foreign military sales? That was a GAO recommendation. That is what the General Accounting Office said. The Department of Defense and the State Department fought the idea of getting the Department of Labor and Department of Commerce into this area of foreign military sales.

Mr. **Feuerwerger**. I am sorry, sir, I don't know.

Mr. **Wyden**. Tell me about the Defense Department and the F-18 with Canada, 100-percent offset. Was there any effort to look at the direct economic impact on our civilian economy?

Mr. **Crossman**. Mr. Chairman, we were not involved in that entirely commercial transaction other than the initial question of whether the sale as such was in our national interest in terms of transferring an American aircraft to Canada, which is a fairly easy question to answer.

Mr. **Wyden**. It seems to me that after 4 hours, the GAO has raised real concerns about the offset situation. The impact of offset situations. We have been told by the Commerce Department and the Labor Department that they have no real involvement in the process.

The Department of Defense is not analyzing economic impacts. We have got a situation where nobody is out there looking out for the U.S. economy, and we have got, just from the General Accounting Office, a statement I will read:

> Agency comments, the Department of Defense agrees with the need for interagency coordination, but believes current procedures provide for careful review of military co-production programs.
>
> Therefore, Defense believes a formal interagency mechanism for review of coproduct requests is neither needed or desirable.

It just seems to me, and I am not going to mispronounce your name again, sir, and I apologize to you for it, that the Department of Defense is simply not giving the attention needed to the domestic economy that needs to be done, and that last statement from the General Accounting Office indicates not only has it not been done in the past, but that the Department is not going to work with other agencies like Commerce and Labor to try to develop a situation in the future to protect our economy and protect our jobs, and I think that is a very serious matter, and it is something that this subcommittee is going to try and correct, and unless you gentlemen have any further comments that you would like to make, we will excuse you and pursue this matter another day.

Mr. Feuerwerger. I think it is premature to say what our reaction will be until after we have seen the results of the report we are currently working on.

Mr. Wyden. I very much hope as a result of this hearing that you will reconsider your previous position, being opposed to interagency agreements with Commerce, Labor and other agencies to look at the economic impact, what these decisions mean, because on the basis of this hearing, this subcommittee understands full well economic impacts are dramatic, we are losing jobs, and we got to turn the situation around.

The subcommittee is adjourned.

[Whereupon, at 2:05 p.m., the subcommittee was adjourned.]

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